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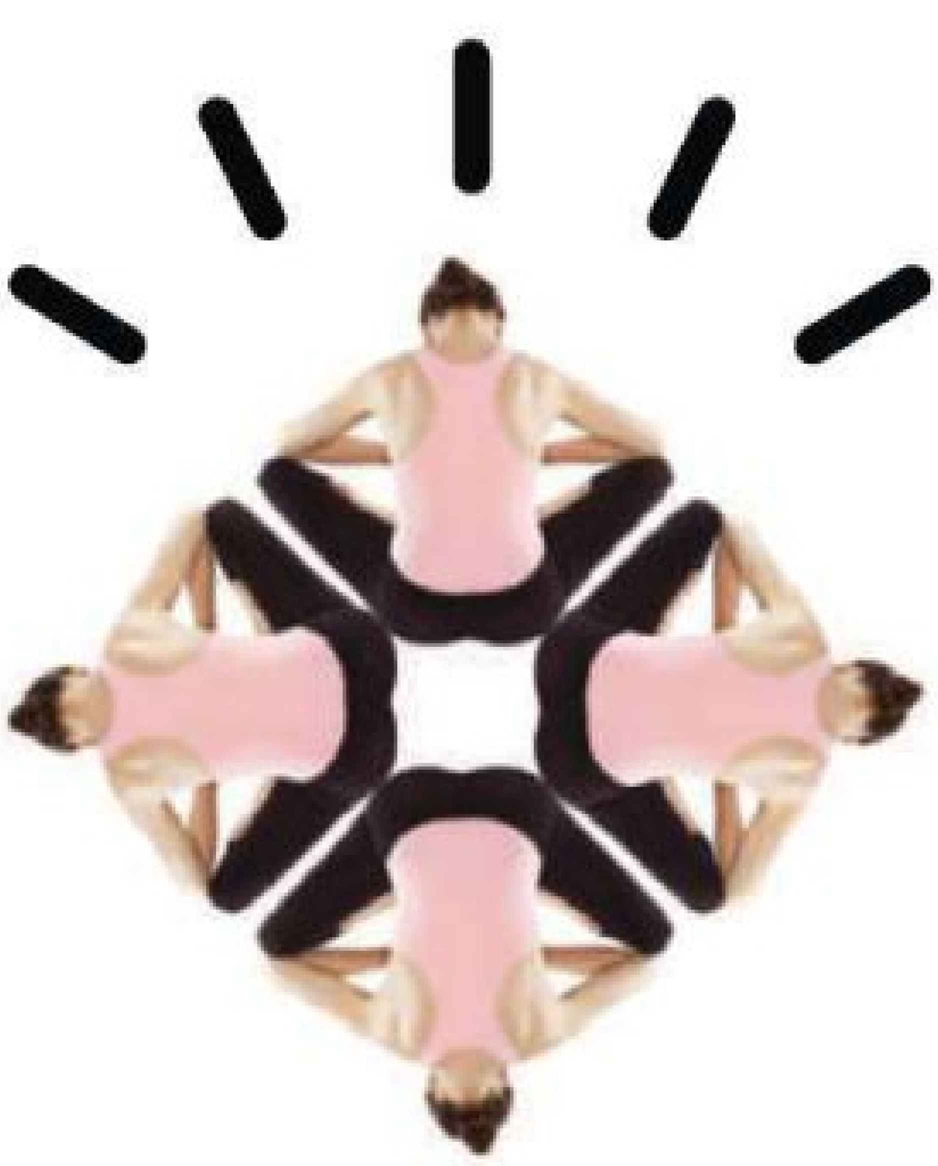
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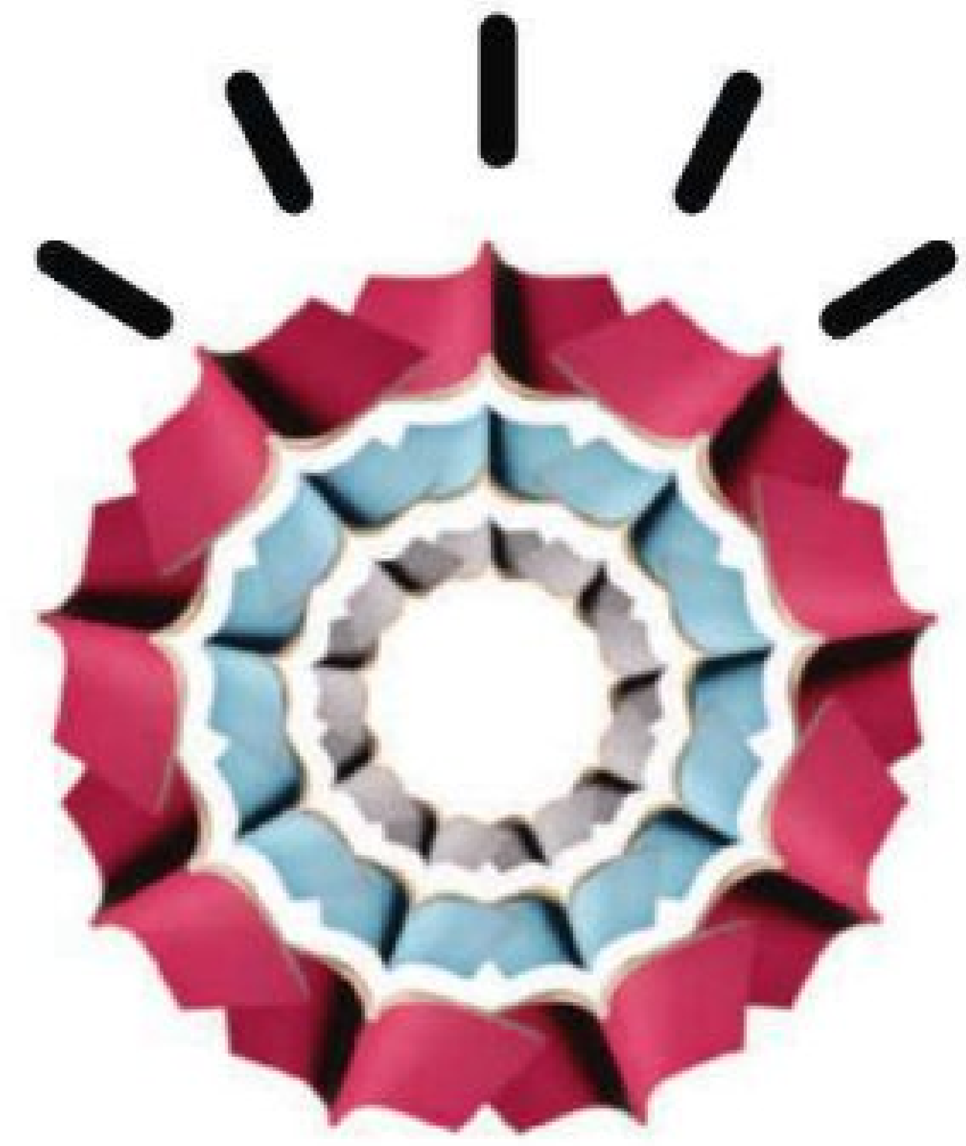
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Corrections & Clarifications

In "A Bailout Cop Trains Fire on the White House" (Politics & Policy, Nov. 15), a quote by Neil Barofsky, the Special Inspector General of the Troubled Asset Relief Program, should have said the Treasury Dept.'s revised estimate of the cost to rescue American International Group "leaves them vulnerable to criticism that they're just manipulating numbers for a big PR push."



Gramo A/S is rewriting the book on energy solutions.
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Feedback

U.S. Chamber of Horrors?

Regarding "Obama's Tormentor" (Features, Nov. 8): Where was the U.S. Chamber of Commerce during the eight years where President Bush added to the national debt an amount equal to that incurred by all Presidents before him? The focus and energy spent by the Chamber of Commerce highlights the crisis America faces from the leadership at the highest levels of industry.

Looking to politics and government to resolve their business issues, Mr. Donohue wants less regulation, yet during Bush's watch the banks were not sufficiently supervised, and the public is left with an immense bailout. Business' primary focus is to remain in the cozy comfort of the 20th century, despite a burgeoning global population and a deteriorating environment.

The U.S. faces a shortage of serious leadership. Obviously the U.S. Chamber of Commerce is a leader of the problem, not the solution.

Larry Mowrer
Lincoln, Calif.

How interesting. A third-rate hit piece on the U.S. Chamber of Commerce in a pro-business magazine. Who knew that the Chamber is just a bunch of fat-cat lobbyists standing in the way of the probusiness agenda of the Democratic Congress?

James R. Dailey
Brimley, Mich.

A Bad Dream

"The Valedictorian's Dilemma" (Politics & Policy, Nov. 15) expressed, in my opinion, the view that undocumented illegal immigrant students should be considered for U.S. citizenship despite blatantly lying on applications to Ivy League schools and colleges. They do this to better themselves by breaking the laws of the U.S.? Am I missing something here? At least 18 students, according to the article, have been approved for full-ride scholarships to attain a bachelor's degree at Harvard, paid for by the college and ultimately the American taxpayers.

The proponents and supporters of the Development, Relief and Education for Alien Minors (Dream) Act are very clear in their demand for this bill to pass Congress, despite the misleading language of the bill, which would allow for "illegal immigrant minors" to gain U.S. residency as a direct result of their parents breaking U.S. federal immigration laws. The fact that they were under 16 years old when they came illegally to the U.S. does not change the fact that they turned 18 and became adults, illegally. Had these students committed any federal crime at 18, they would have been treated as adults, so why is this fact simply forgotten when dealing with college students who break the law and lie to gain a free education?

I found the article both interesting and perplexing. You see, I'm a legal immigrant living in the U.S. for nearly 10 years and educated in England. I'm a proud holder of an electrical engineering bachelor's degree, with 26 years' experience in electrical power studies, and I'm still waiting for the U.S. Immigration Service to process my petition for permanent residency.

I'm not opposed to illegals gaining a better life, but the Dream Act does not take into account the legal residents who have followed all the rules and yet face prejudice.

John Carroll
Chandler, Ariz.

Lay Off the Layoffs

"Former Executives Bomb at the Ballot Box" (Politics & Policy, Nov. 8) made a telling point regarding Carly Fiorina's failed campaign. Over and over we saw those commercials damning her for the outsourcing of jobs. Obviously, this was a major issue for the voters in California. Why isn't it a major issue for the fresh-out-of-business-school hotshots on Wall Street? Every time a company announces job layoffs to achieve greater efficiencies, it is rewarded by analysts. The same companies come back next year with another round of cutbacks. And the next year, and the year after that.

Isn't it time that layoffs got corporate managements a black eye for not being prudent enough to manage their staffing better? Layoffs cost a lot in severance. Layoffs kill internal company morale.

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Layoffs give the company a bad reputation among the general public.

Am I the only investor who looks at a company's record of staff reductions as an indication of its incompetence?
Dave Ingraham
San Diego

Right, Wrong, and Mortgages

"Shredding the Dream" (Features, Oct. 25) was insightful in many ways. Foremost was Mr. Lents' position of forcing the noteholder to produce the promissory note for his residence. "It's the law," he says. Funny that a guy of high legal principles would only apply those principles when it benefits himself. The security sales laws he was supposed to follow evidently didn't apply to him—or they were inconvenient. Law or no law, there is right and wrong. He knows he owes some amount on his mortgage. No doubt he can produce his copy of the promissory note. Why not simply do the right thing? Mr. Lents' sense of right and wrong must be situational. If it's in his best interest, he will do what is right, or what is wrong—it doesn't matter as long as his interests are served.

There is plenty of blame to go around, but there is right and wrong. It starts with the individual owning up to his/her mistakes, bad luck, misfortune, or whatever. Do what's right and move forward.
Paul Humes
Pickerington, Ohio

'We Want Smaller Government'

Although one is not entitled to his own facts, Jon Meacham can certainly twist the facts in his disgruntled, pious analysis of the election ("Beyond the Extremes," Opening Remarks, Nov. 8). Excuse me, Mr. Meacham, my taxes have gone up (maybe in the liberal universe, real estate taxes don't count), and I am still searching for those tax cuts that 95 percent of working families received under Obama.

Apparently when Republicans win it is by "brute force," as opposed to by deception, when Democrats win. Save your whiny, arrogant opinions for your liberal friends and don't sermonize on the need for "enlightened pragmatism," as if the electorate is irrational when they don't vote Democratic.

We know what we want, obviously you don't. We want smaller government (as Thomas Jefferson encouraged), less taxes, no Obamacare, no energy taxes, and less spending. Is that so hard for you to understand? No country ever taxed its way into prosperity.

By claiming that *The New York Times* (the bastion of liberal propaganda) is the disseminator of the truth shows where your true sympathies lie. So please don't insult our intelligence with your "enlightened" view of the election. The politicians know that this time we will keep their feet to the fire and not accept this continued drift toward socialism.
Igor Shpudejko
Mahwah, N.J.

I subscribe to this magazine, but I'm not sure why after reading big-time lefty Jon Meacham's Opening Remarks. Meacham couldn't recognize misguided economic policy if it slapped him in the face. Even his writing style is elitist. This whole joint needs a vacation from the Fed being so important in their lives.

Guess you guys missed the point a couple of Tuesdays ago. Pick it up or I'm gone.
Denny J. Lamers
Neenah, Wis.

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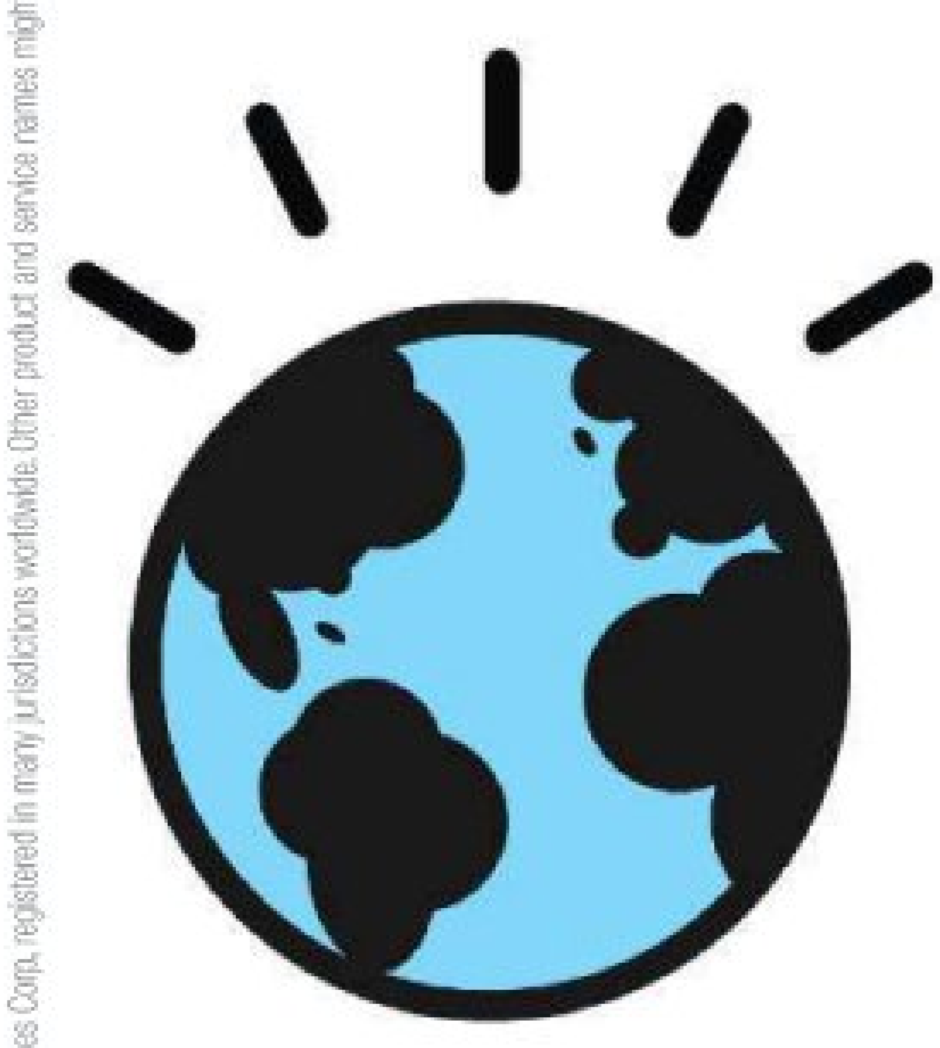
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Opening Remarks



ILLUSTRATION BY STEVE CAPLIN

These Scissors Won't Cut

New proposals to get serious about the U.S. budget deficit are colliding with the same old dysfunctional politics. By Peter Coy and Heidi Przybyla

In the space of a week, the chiefs of two blue-ribbon panels in Washington have put forth tough-minded proposals for reining in federal budget deficits. The ugly reality that they emphasized–no less true for being so often described or so reliably ignored–is that Americans have undersaved, overspent, and made unaffordable commitments for the future, particularly on retiree health care. The IOUs are accumulating, and if nothing is done soon, the chits will hit the fan: Creditors will stop lending money or at least demand much higher interest rates for it, as they already have in Greece, Ireland, and Iceland.

Each deficit-reduction proposal was full of serious ideas, and each was greeted by immediate and deadly sniper fire from both sides of the aisle. Postponing action is irresistible because the political blowback from doing anything meaningful is scorching. Every interest group is passionately committed to defending its own sacred cow, trampling the concept of sharing the pain for the common good. Washington, it appears, still isn't ready to grow up.

Those ringing the deficit alarm tend to be old and indignant. Peter G. Peterson, the 84-year-old retired banker, invested $1 billion in a foundation focused on fixing budget deficits, foreign debt, and entitlement spending. He ruminates about the morality of a society that leaves a legacy of debt. "I have nine grandchildren," Peterson says. "I think a lot about them." Alan K. Simpson is 79. The former Republican senator from Wyoming, who is co-chairman of President Obama's bipartisan National Commission on Fiscal Responsibility and Reform, told Bloomberg Television's Charlie Rose on Nov. 16 that he was too old to play budgetary politics anymore. "We're not going to sign our names at this stage of life to a bunch of pap," Simpson says he told his co-chairman, Democrat Erskine Bowles, 65, the North Carolina businessman who served as White House Chief of Staff for Bill Clinton. Says Simpson: "We call it the cruelty of making promises you can't keep."

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Simpson and Bowles issued the first deficit-reduction proposal on Nov. 10, one week before former White House budget director Alice M. Rivlin, a 79-year-old Democrat, and Pete V. Domenici, 78, the former Republican senator from New Mexico, unveiled the recommendations of the Bipartisan Policy Center commission that they co-chair. With old-timey affection, she calls him "Senator Pete"; he calls her "Doctor Alice." But their admonitions are grim. Letting deficits continue to run out of control, they warn, would "make us increasingly vulnerable to the dictates of our creditors, including nations whose interests may differ from ours."

Simpson and Bowles proposed to shrink or kill the sacrosanct income-tax deduction for home mortgage interest; slash $100 billion in defense spending, in part by closing bases; freeze the pay of federal workers, excluding combat forces, for three years; raise the gasoline tax by 15¢ a gallon; cut Medicare reimbursements to doctors, hospitals, and drug companies; shore up Social Security with tax hikes and benefit cuts; and sharply curtail the growth of federal health expenditures. Rivlin and Domenici rely more on increasing revenue to balance the budget. They call for a 6.5 percent national sales tax, which they package for public consumption as a "Debt Reduction Sales Tax."

Among Democrats, House Speaker Nancy Pelosi almost instantly labeled the plan of the Obama commission co-chairmen "simply unacceptable." On the Republican side, Americans for Tax Reform gravely warned that "support for the commission chair plan would be a violation of the Taxpayer Protection Pledge which over 235 congressmen and 41 senators have made to their constituents."

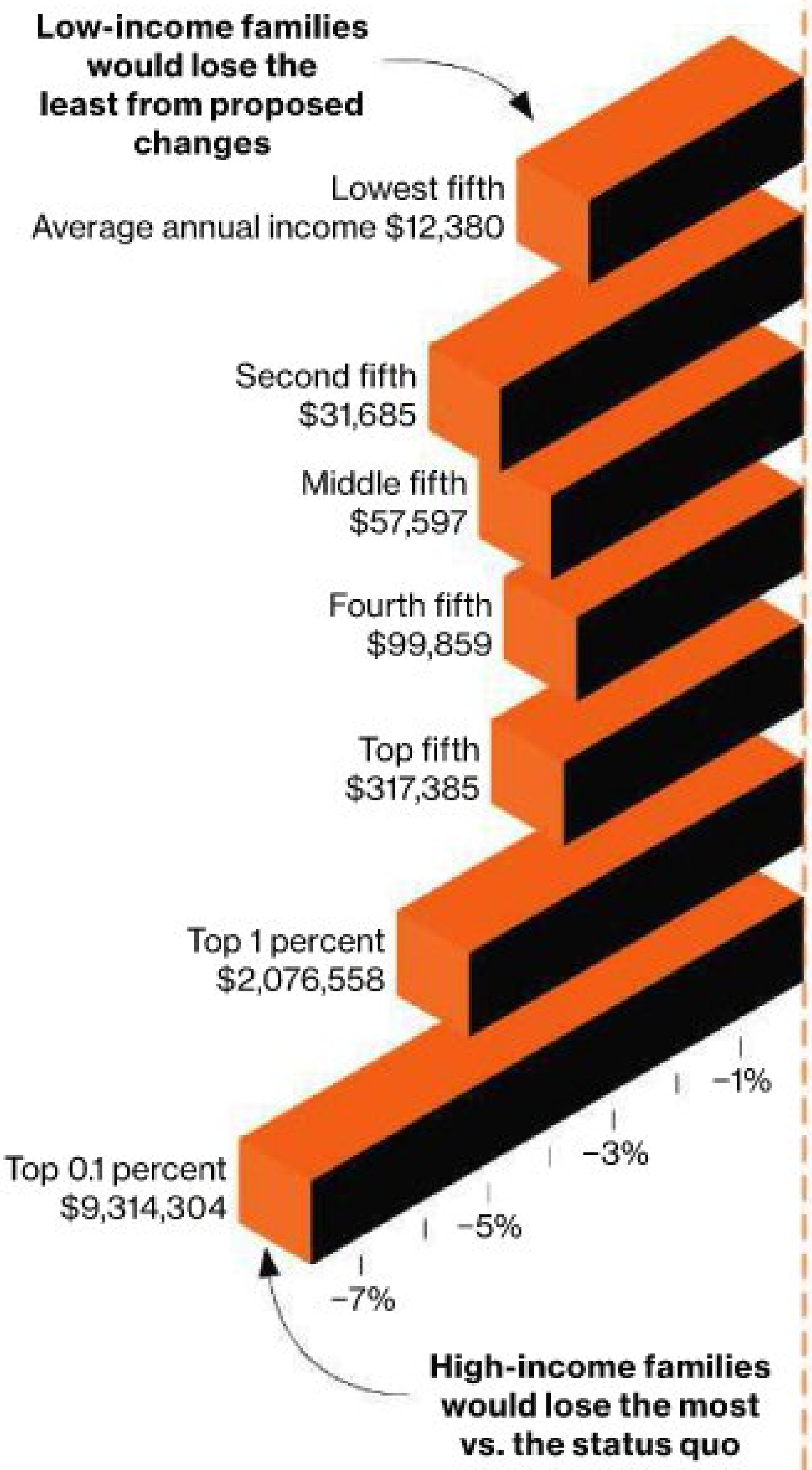
The fact is, it's impossible to balance the budget without infuriating the followers of both Pelosi, who will lose the Speaker's chair in January, and Grover Norquist, the single-minded president of Americans for Tax Reform. The U.S. can't put its house in order without deep spending cuts *and* revenue increases.

Consider first the case of the antitax purists: To meet the commission's goal of reducing the deficit to 2.2 percent of gross domestic product by 2015 yet not raise taxes, lawmakers would have to find $98 billion in spending cuts beyond those in the Simpson-Bowles plan. Getting all the action on the spending side would be painful, especially if it's from discretionary spending rather than entitlements. Defense cuts in the plan are already steep. Defense Secretary Robert Gates on Nov. 16 said he's willing to take some reductions but called the Simpson-Bowles plan "math, not strategy." Wiping out the entire Justice Dept., including all federal prosecutors, the FBI, and the U.S. Drug Enforcement Administration (projected 2015 budget: $32 billion), would get the GOP less than a third of the way to the Simpson-Bowles target. Eliminating the entire food stamp program in addition ($66 billion) would pretty much close the gap, but at the expense of an epidemic of malnutrition. Another option would be to eliminate the Energy Dept. ($28 billion), Interior ($12 billion), and unemployment insurance ($48 billion). Paul Ryan, the Wisconsin Republican who is the next House Budget Committee chairman, says the GOP has no intention of stopping critical government functions, adding, "there are a lot of ways for government to be cut." True, but how deeply? "If you want to do it all on the spending side under current law you'd have to constrain spending so it doesn't grow at all for the entire decade," says Gene Steuerle, a senior fellow at the Urban Institute in Washington.

The Democrats are equally unrealistic in attempting to shield completely the entitlement programs such as Medicare, Medicaid, and Social Security that represent about 40 percent of federal spending. The task quickly becomes impossible as the baby boomer generation retires. Representative Jan Schakowsky, an Illinois Democrat who sits on Obama's deficit-reduction panel, on Nov. 16 released a plan for the short term that includes an increase in taxes of $275 billion by

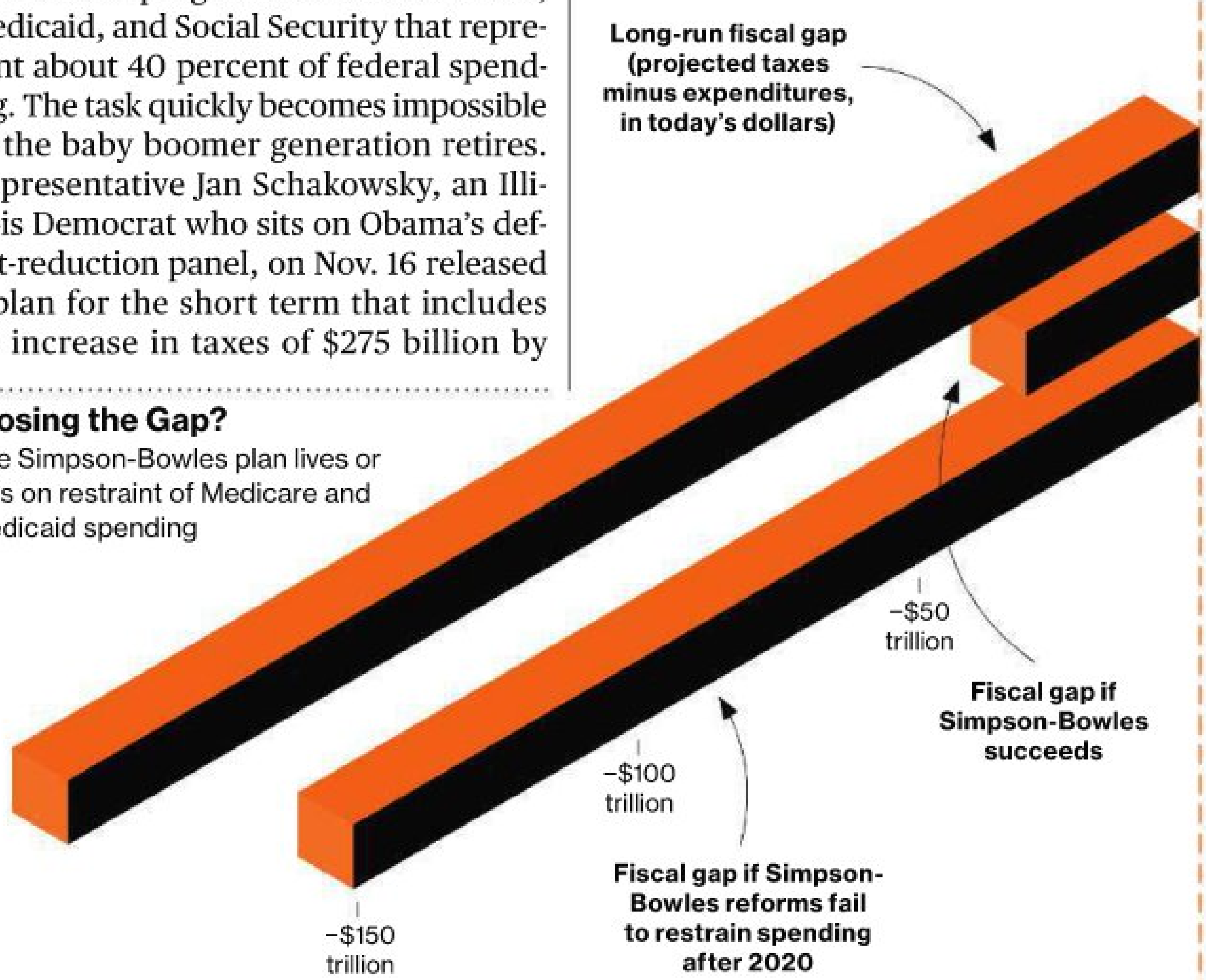
Spreading the Pain

Percentage change in aftertax income by 2015 under Simpson-Bowles by income bracket*



Closing the Gap?

The Simpson-Bowles plan lives or dies on restraint of Medicare and Medicaid spending



*COMPARED WITH EXTENDING THE BUSH TAX CUTS IN FULL. BASED ON VARIANT OF SIMPSON-BOWLES THAT ELIMINATES MOST DEDUCTIONS, INCLUDING FOR HOME MORTGAGE INTEREST, BUT RETAINING CHILD AND EARNED-INCOME TAX CREDITS
DATA: TAX POLICY CENTER, LAURENCE KOTLIKOFF

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2015. Even a tax hike that large doesn't suffice past 2015, when boomer retirements start to kick in. "We haven't figured that all out yet," Schakowsky acknowledges.

One fat revenue target for the Democrats would be ending most income-tax deductions. The Simpson-Bowles plan offers three options on taxes, including a "zero option" that would fully wipe away the more than 300 tax deductions, credits, exclusions, and other breaks subsidizing everything from health care to housing. But those deductions and credits are immensely popular. The elimination of mortgage-interest deductions alone "would be a huge capital loss for anybody currently owning a home because people would not be willing to pay as much for houses," says Roberton Williams, a senior fellow at the Washington-based Urban Institute. The change "would drive prices down substantially," Williams says.

O.K., but if Democrats leave the deductions and credits alone, where will the money come from? Raising income tax rates on the wealthy is a Democratic favorite. But the Democrats would have to hike taxes on more than just the wealthy. Even if lawmakers ratcheted up the top two tax rates to an unthinkable 91 percent and 86 percent, from the current 35 percent and 33 percent, the government would still show a deficit totaling roughly $500 billion by 2019, according to researchers at the Washington-based Tax Policy Center, a project of the Urban Institute and Brookings Institution think tanks. "You end up with ridiculous marginal tax rates," said Donald Marron, the center's director. "It's just not feasible."

Balancing the budget isn't just an accounting exercise. It's about setting national priorities, weighing competing concepts of fairness, and creating incentives to promote growth. Cutting the budget in a way that simply off-loads costs onto states, localities, businesses, or families doesn't do Americans as a group any good. It's taking money out of one pocket and putting it in another. The benefits come when spending and taxation policies induce greater efficiency, and when they stimulate investment for future prosperity as opposed to consumption.

To its credit, the Simpson-Bowles plan would fix some of the "misincentives" buried in the nightmarish Internal Revenue code. All three of the proposal's tax options would subject more of Americans' income to taxation. That would make it possible to raise the same amount of money with lower rates, or raise more money without raising rates. That's a good thing. Lower rates on the last dollar of income earned encourage people to work and save more money, which in the long run is the least painful way to balance the budget. The knee-jerk rejection of the Simpson-Bowles tax ideas by some GOP activists is hard to understand: Cutting marginal tax rates is precisely the type of reform that free-market economists favor.

Balancing the budget is about setting national priorities and creating incentives for growth

Democrats who howled that the Simpson-Bowles plan was stacked against the poor were also mistaken, according to a preliminary analysis by the Tax Policy Center. The center studied a variant of the plan that gets rid of the home mortgage deduction but keeps the child credit and the earned income tax credit for low-income workers. That variant is worse for the rich than extending the Bush tax cuts in their entirety (see chart). The top 1 in 1,000 families by income would see aftertax income fall by 7.8 percent, more than any other income tier, according to the group's analysis.

What's really scary is that as painful as their prescriptions are, neither Simpson-Bowles nor Rivlin-Domenici is assured of bringing the budget into long-term balance. What's causing the long-term numbers to go kerflooey: Medicare and Medicaid. Both panels assert that the government will reduce the annual growth of its health-care spending to one percentage point above the growth of economic output, vs. predicted growth of GDP plus 1.7 percent. Vaguely, Simpson and Bowles say that will happen "by establishing a process to regularly evaluate cost growth, and tak[ing] additional steps as needed if projected savings do not materialize." That's more an aspiration than a plan, sounding like Steve Martin's joke about how to become a millionaire and not pay taxes: First, get a million dollars. Then, don't pay taxes. The Rivlin-Domenici plan would convert Medicare from a defined-benefit plan into a defined-contribution plan, like a health-care 401(k), but there's no guarantee that doing so would slow its cost growth.

Here's the depressing math. Boston University economist Laurence Kotlikoff, an expert in generational accounting, calculates using Congressional Budget Office data that the U.S. faces a fiscal gap of about $200 trillion. That's the shortfall between the expected inflows and expected outflows of the federal government in perpetuity, based on current policy and discounted back into today's dollars. (The ideal fiscal gap is zero dollars, by the way, so we're more than a little off.) By Kotlikoff's back-of-the-envelope calculation, which he presented in a column for Bloomberg News on Nov. 15, the Simpson-Bowles plan would reduce the fiscal gap to about $30 trillion. Still huge, but much better. However, if the deficit cutters' hand-waving over health-care costs fails and noninterest spending continues to rise after 2020 at the rates projected by the Congressional Budget Office, Kotlikoff estimates a fiscal gap of about $150 trillion under the plan—too high for even the world's biggest economy to sustain. Says Kotlikoff: "It's miles short of what's needed."

The political deadlock in Washington is making matters worse. In their willingness to reach across the aisle, "Doctor Alice" Rivlin and "Senator Pete" Domenici are anachronisms. From the 1950s through the 1970s, the ideologies of the Democratic and Republican parties overlapped—each was a big tent sheltering politicians with a wide range of viewpoints. Bipartisanship didn't always promote budget discipline: Democrats went along with Republicans' big defense budgets, for example, while Republicans acquiesced to Democrats' social spending. Today's political polarization doesn't seem to be good for budget-balancing, either. The latest election drove the parties further apart by casting out many Blue Dogs, the centrist Democrats who sometimes bridged the two parties' differences.

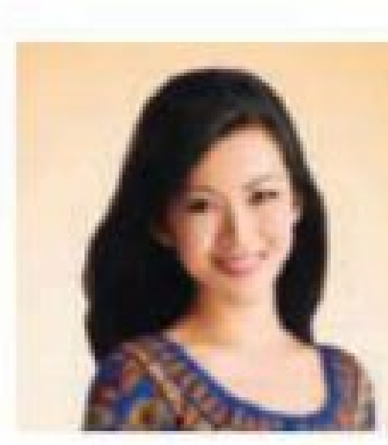
Is there any hope? Peterson is staking a billion dollars that the answer is yes. His foundation's latest public-awareness campaign features a Presidential candidate, Hugh Jidette ("huge debt"), whose motto is "borrow like there's no tomorrow." Corny, yes. But as Peterson observes: "Someone once said that the job of the public is often to make it safe for the politicians to do the right thing." In other words, Washington won't grow up until America does. *—With Brian Faler, Jodi Schneider, and Viola Gienger*

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Charlie Rose talks to

Erskine Bowles, Alan Simpson



PHOTOGRAPH ILLUSTRATION BY CREDITTK
ALEX BRANDON/AP PHOTO

The co-chairs of the U.S. Debt Commission explain the thinking behind their $3.8 trillion fix for America's afflicted budget

What motivated the two of you to release this plan?
Erskine Bowles: We have to start the dialogue. The path we're on is unsustainable. Every member of Congress knows that. And I think we had to lay a predicate out there that would force action by this Congress and future Congresses. I think the problem is that deep.

Alan Simpson: I was interested to hear the other day that Admiral Mike Mullen [chairman of the Joint Chiefs of Staff] said that debt is the biggest national security problem we have. You and I know, Charlie, as business guys, that if we don't get this debt under control it's going to crowd the private sector out of the market, and small businesses can't grow and create jobs. You have to think about all those people who want to make sure that we invest in education and infrastructure and high-value-added research and development. We can't do that if we continue to have this amount of debt build up in the country. It just will eat the budget alive.

So tell me how you made your choices about tax cuts vs. spending cuts?
Bowles: We listened. We think we have bigger problems on the spending side than on the revenue side. We then tried to look not at just hard numbers but tried to figure out what we could really cut. As an example, we've made $163 billion of cuts in the discretionary budget in the year 2015. The President gave us a goal to get to 3 percent of GDP. We actually got to 2.2 percent of GDP [offering] specifics, things we would actually cut out of a budget.

Paul Ryan [one of the 18 members of the Debt Commission and the incoming House Budget Committee chairman] wants to know why you didn't take on health care.
Bowles: We don't do as much as Paul would like us to do, but we have ... $500 billion worth of cuts in the next 10 years. That's no small potatoes. Where do we get the money from? We get the money from providers, from doctors themselves, from drug companies, from hospitals. We also get the money by charging people more for the services they are provided. And we get the money from lawyers. We have real tort reform in this package.

Simpson: There isn't any question we touched health care. We dinged Medicaid, Medicare, Social Security, the whole works.

What's your proposal say about Social Security?
Bowles: I think we've taken a very balanced approach. We closed the gap to get to 75-year solvency.

Simpson: That's the key. We're not balancing the budget on the back of Social Security. That's just garbage.

Bowles: If we stay on automatic pilot, the Social Security trust fund runs out in 2037. What we do is try to address that now. We raise a little bit of revenue. We have a few benefit cuts, principally on the upper-end people so that we can preserve Social Security's solvency for 75 years.

What about the Bush tax cuts?
Bowles: If you give more tax cuts, you lose revenue. First of all, I don't think people like you and me need a tax cut, Charlie. We've said, let's broaden the base, simplify the code, bring down rates, and cut the deficit. There are $1.1 trillion worth of tax expenditures, what I call spending, in the tax code that basically benefit people like us. What we're saying is, let's eliminate them. Charitable deductions, mortgage-interest deductions, deductions for state and local taxes. And if we eliminate them, let me tell you what we can do on income-tax rates. We can [bring them down] to 8 percent, 14 percent, and 23 percent. And we can take the corporate rate down to 26 percent.

Simpson: We're going to unleash a pile of scratch that those corporations are holding back. They're just looking around wondering what's going to happen in this country. What is it they have, $2 trillion or something that they're holding back?

How did we get here?
Bowles: It's frightening. We'll be paying a trillion dollars in interest costs in 2020.

Simpson: I can tell you exactly how we got here. For the last 75 years we were sent to Washington to bring home the bacon. We were sent to Congress to get money. If they got it, they were reelected.

That's how the system became dysfunctional?
Simpson: You bet.



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

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Drop Russia



Add Indonesia: The Debate Is On

▶ **Detractors say Russia no longer deserves a spot in the famous investment quartet**

▶ **"Indonesia has the potential to become a key global player"**

Goodbye BRIC, hello BIIC?

In 2001, three years after Russia's ruble collapsed, **Goldman Sachs** named the country a member of the BRICs–Brazil, Russia, India, and China–the emerging markets it said would be four of the most dominant economies by 2050. Over the next several years, BRIC-fixated investors piled into Russia as its resource economy thrived in the era of fast-rising oil prices. The BRIC concept still asserts its power. Investors in the $48 billion **iShares MSCI Emerging Markets Index Fund**, for example, have nearly half their money weighted in BRIC stocks.

For plenty of money managers and economists, however, the Russo euphoria is all but gone. From Nouriel Roubini to Morgan Stanley, they are calling either for Russia to be ousted from the BRICs altogether in favor of Indonesia or, at the least, for Indonesia to join the other four. They are put off by the policymaking drift in the Kremlin, Russia's demographic atrophy, and endemic corruption. Indonesia's fiscal prudence, economic growth–6 percent this year, according to the International Monetary Fund–and strengthening social and political institutions have far more appeal. Twice-elected President Susilo Bambang Yudhoyono has directed funding toward schools and health care, and Indonesia's coffers are full enough to put the onetime IMF bailout case on the brink of an investment-grade credit rating.

"While Indonesia isn't a paragon of virtue, it's better," says one money manager

Russia, for its part, cannot seem to escape the investor-unfriendly headlines. Sweden's **Ikea** has leased diesel generators to circumvent Russian bureaucrats who allegedly demanded bribes to provide electricity to the chain's stores. Then the Swedish retailer revealed that the Ikea executives in charge of leasing the generators were taking bribes, too. Petro oligarch Mikhail Khodorkovsky has been in jail on fraud charges since 2003: His supporters say the charges were trumped up to give the Kremlin an excuse to seize his company. (The government denies

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this; Khodorkovsky is on trial for fresh charges.) William Browder, chief executive officer of **Hermitage Capital Management**, once Russia's top foreign investor, was banned from the country in 2006 for tax evasion: He says his company was grabbed by criminals who pulled off the tax scam. "Russia is just not a good place to put your money," says Richard Shaw, managing principal of QVM Group, a South Glastonbury (Conn.) investment advisory.

Shaw says he avoids putting clients in Russian stocks and funds, and steers clear of BRIC-linked investments because of their Russia exposure. He would rather own Indonesian exchange-traded funds: "While Indonesia isn't a paragon of virtue, it's better, especially to participate in the Asian boom." Although some investors want BIIC to replace BRIC, Shaw votes for BICI (pronounced BEE-chee): "It's catchy—kind of sounds like an Italian purse."

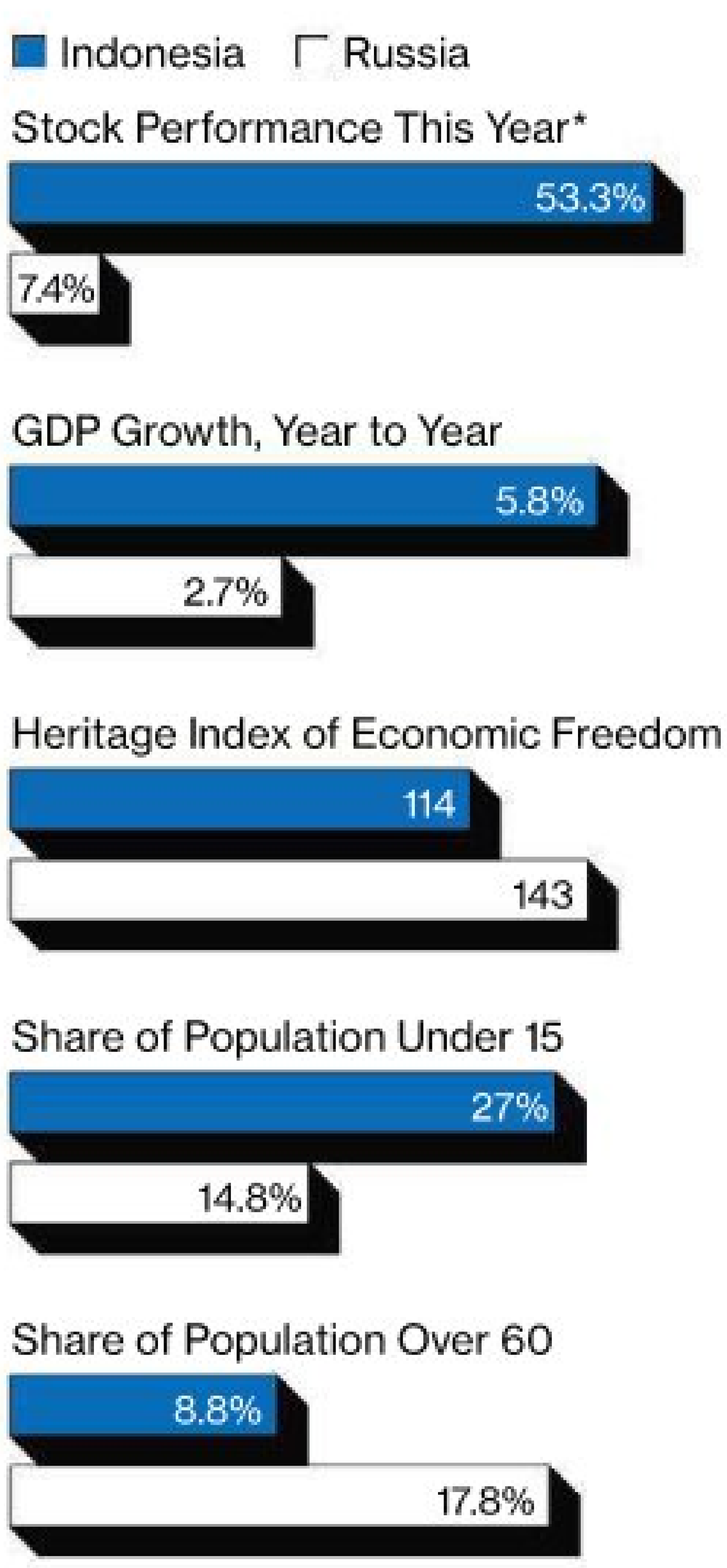
Indonesia, the world's fourth-most-populous country and largest Muslim democracy, has corruption, too. In part, that's a legacy of the Suharto dictatorship that ended in 1998. Yet Tom Lydon, president of Global Trends Investments, says the Asian nation has more going for it than Russia. "Beyond natural resources, it is supported by improving domestic consumption, and anticorruption efforts appear to be working." Indonesia has sentenced several politicians and former ministers for corruption. In its latest Global Competitiveness Report, the World Economic Forum ranked Indonesia 44th out of 139 countries—up from No. 54 the prior year. (Russia came in at No. 63.)

While **Morgan Stanley** has called for Indonesia to join the BRICs—Goldman has called the country a "Next-11" nation, in a runner-up list of sorts—economist Nouriel Roubini of New York University has argued that Indonesia should replace Russia in the bloc. "From an American perspective," he wrote last year in a column, "Indonesia is an attractive alternative to Russia, which has vied with Venezuela for leadership of the 'America in decline' cheering section."

The iShares ETF allocates just 2.6 percent of its money to Indonesia. That will change, say Indonesia backers; 12 years after its financial crisis the archipelago is China's third-largest trading partner, foreign investment has more than tripled since 2004, and gross domestic product is growing faster than Russia's. While Russia's Micex index has fallen 22 percent from its December 2007 peak, the Jakarta Composite Index is approaching an all-time high. Russia's market fortunes have fallen so low that some investors are taking a second look, especially since Russian corporate profits have been robust. "Russia really stands out as being cheap and attractive," says Maarten-Jan Bakkum, an emerging-market equity strategist at ING Investment Management in The Hague.

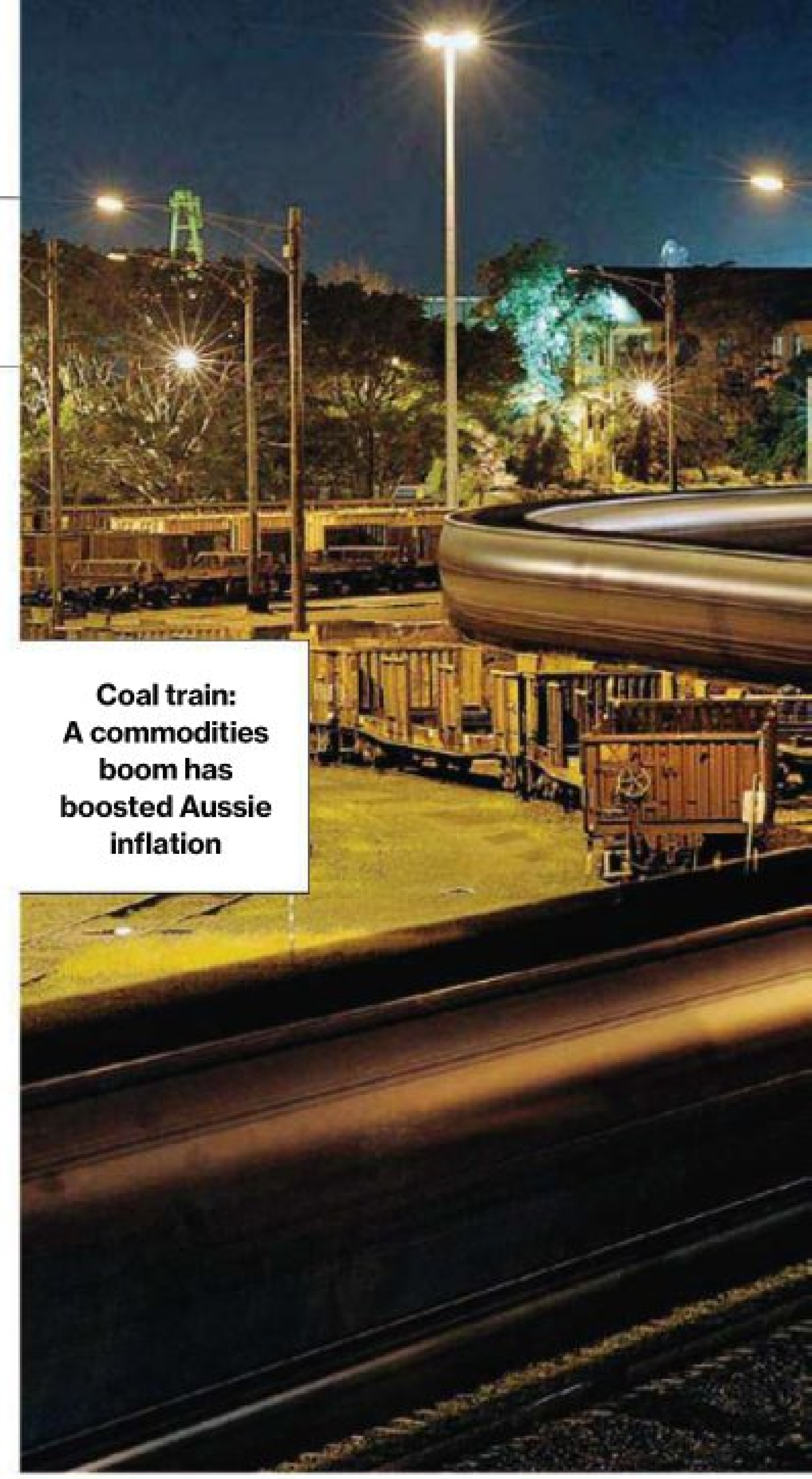
Indonesia's supporters say that over the long haul the Asia nation has the edge. More than half of the population is under 30, while aging Russia faces a paucity of productive labor. The Kremlin may have to commit increasing sums to care for the elderly, says Wijayanto, managing director of the Paramadina Public Policy Institute in Jakarta. "Indonesia," he says, "has the potential to become a key global player." —*Roben Farzad*

Asian Giant vs. Slavic Titan



*INDONESIA: JAKARTA COMPOSITE; RUSSIA: MICEX
DATA: BLOOMBERG, HERITAGE FOUNDATION

The bottom line *Russia's inability to develop into a mature economy has prompted investors to call for the country's removal from the BRIC group.*



Coal train: A commodities boom has boosted Aussie inflation

Currencies

The Aussie Soars, the Central Bank Shrugs

- The Reserve Bank refuses to intervene. Instead, it's hiking rates
- "The Australian dollar is among the world's new safe havens"

At a time when nations from Japan to Brazil are struggling to keep currency gains from damaging their economies, Glenn Stevens, governor of the Reserve Bank of Australia, the central bank, is taking the road less traveled. He's welcoming a stronger exchange rate.

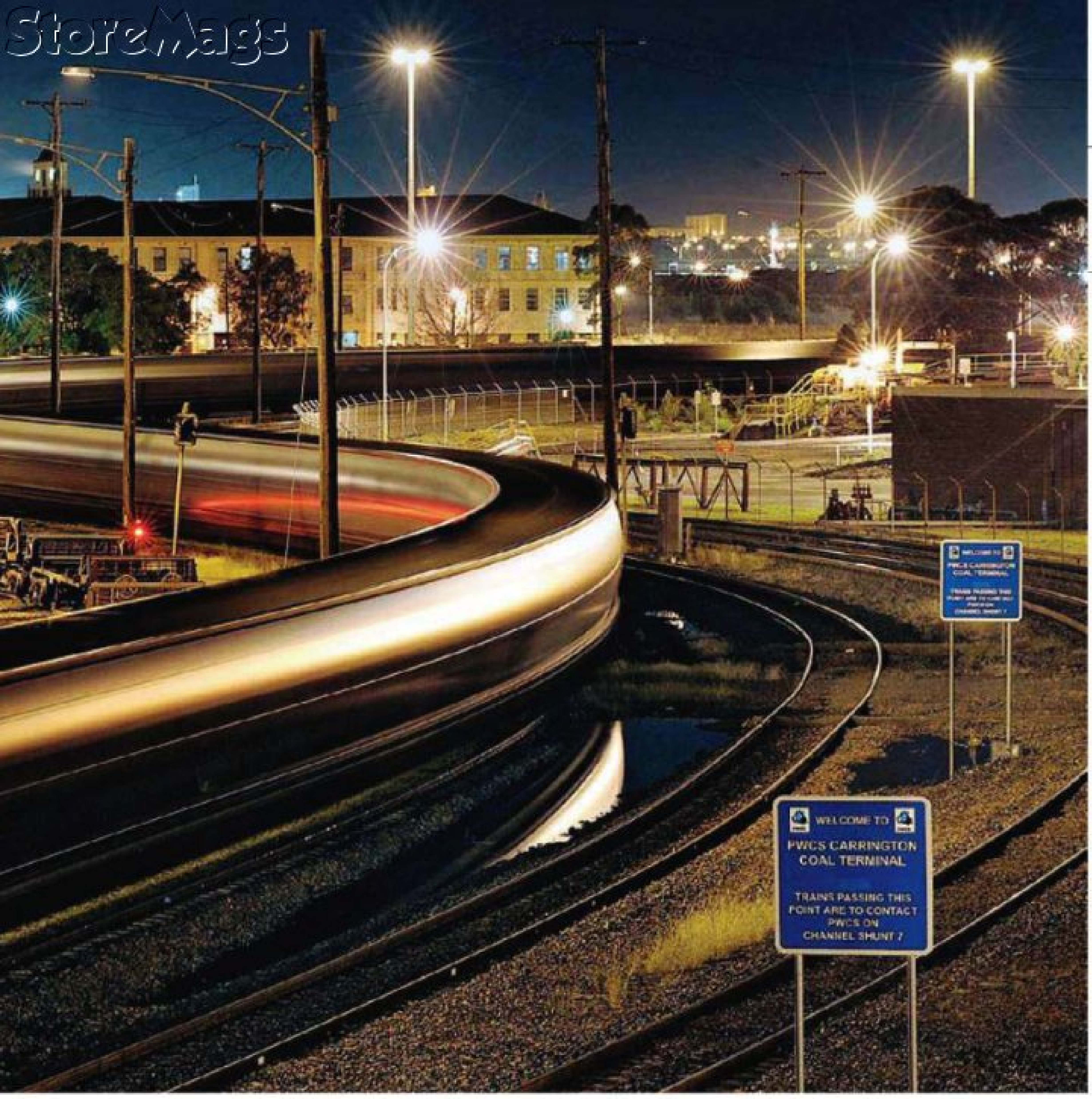
Australia's dollar (nickname: the Aussie) has advanced 17 percent against the greenback since the end of June, the biggest gain of the 16 major currencies tracked by Bloomberg. It recently reached parity with the U.S. dollar for the first time since July 1982. Stevens figures a combination of a stronger currency and higher interest rates—he's hiked rates seven times in the last 14 months—will quell the country's inflation and keep growth steady.

Prospects for the Aussie, as well as the central bank's hands-off attitude, are tempting some of the world's big-

FROM TOP: JACK ATLEY/BLOOMBERG; ANDREW HARRER/BLOOMBERG

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gest bond investors to pile into the nation's debt, even though Stevens has signaled more rate increases may come. "The Australian dollar is among what we're calling the world's new safe havens," says Jonathan E. Lewis, founding principal of New York-based **Samson Capital Advisors**, which manages $6.9 billion and specializes in bonds and currencies. Lewis has twice the percentage of Australian dollars in client accounts than what's contained in the benchmark index Samson uses to gauge its performance. Tokyo-based **Kokusai Global Sovereign Open**, Asia's biggest bond fund, boosted its investment in Australia to a record 15 percent of assets this year. The Australian government's Nov. 10 auction of debt maturing in July 2022 attracted bid volume four and a half times greater than the amount of available securities.

Investors love the appreciating currency and the benchmark rate of 4.75 percent, especially when compared with rates near zero in Japan and the U.S. They don't seem too concerned about the problems forcing Stevens to hike those rates. China's appetite for Australian iron ore, coal, and other commodities has created a red-hot mining sector that is luring workers away from other parts of the economy and driving up wages.

The Aussie has dipped recently on fears that the Chinese government would try to cool off its own economy. Yet the International Monetary Fund predicts China's economy will grow 9.6 percent next year, which should be enough to keep Australian mines humming. The IMF expects that Australia's economy will expand 3.5 percent next year from 3 percent in 2010. What's more, when Australia sells its ore and coal, the deals are priced in U.S. dollars, so the value of Australia's currency does not affect the price for foreign buyers. Chinese imports of iron averaged 51.5 million tons a month this year and last, compared with 37 million tons monthly in 2008.

Could the central bank forsake its neutral stance and intervene if the Aussie gets too strong? Ken Leech, head of the global investment strategy committee for **Western Asset Management**, Legg Mason's bond unit, says he doesn't think the Australians will intervene. Since letting their currency first float freely in 1983, the Australians have been generally reluctant to jump into the markets to prop up or restrain the Aussie dollar.

The Australian currency may also be too hot not to cool off. Its advance has already made it the world's most expensive currency based on purchasing power parity, a measure of the cost of goods relative to other countries. The gauge shows the Aussie is trading at a 30 percent premium to the greenback, according to data compiled by Bloomberg. "It's very overvalued, and it's unlikely to remain that way for a substantial period," says Lee Hardman, a foreign exchange strategist in London at Bank of Tokyo-Mitsubishi UFJ. For investors tired of meager yields elsewhere, it's a good ride while it lasts.

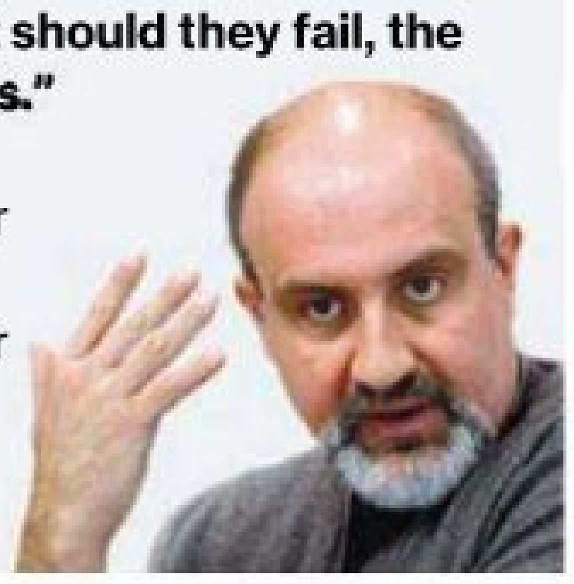
—*Wes Goodman and Candice Zachariahs*

The bottom line *Australia is luring investors, who like the country's high interest rates and strong dollar. The central bank needs to keep inflation in check.*

Quoted

"Bernanke is someone who talks about returns without talking about risk. It's identical to a pilot who talks about speed but not about safety. The measures he is using may work, but should they fail, the risks are humongous."

—Nassim Taleb, economics professor at New York University and author of *The Black Swan*



Recovery

Bond Investors Detect A Whiff of Inflation

- **Options data foresee a moderate pickup in prices**
- **"A rise in yields will create a virtuous circle"**

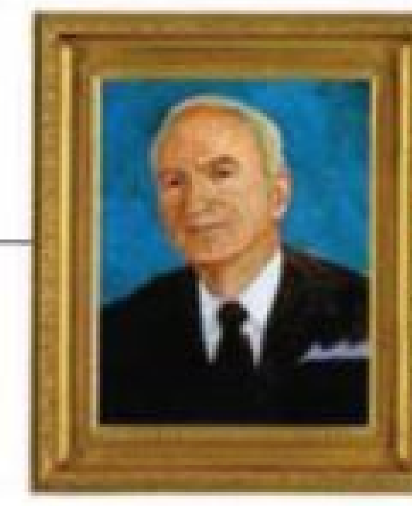
Federal Reserve Chairman Ben Bernanke's $600 billion plan to slay deflation, and perhaps spark some modest inflation, has a chance of working if the market for bond options is any indication. The question is whether his grand plan will engineer a recovery as well.

As the central bank starts a second round of Treasury purchases through its quantitative easing policy, investors are paying eight times more than they did in April for options on interest rate swaps that protect against rising yields, relative to options on swaps

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Lofty pay at for-profit colleges page 31 ▶

that bet on yields falling, according to Barclays data. The difference between these options, which in traders' parlance is called the payer skew, has widened by 23 basis points since early April. When a bond's price declines, its yield goes up. Bond yields often go up when investors expect inflation to accelerate. Conversely, when investors bid up bond prices, yields drop, a sign that more inflation is not expected.

In a quarterly Bloomberg Global Poll of 1,030 investors, analysts, and traders, 56 percent said the Bernanke plan won't boost growth. Half of them, however, did say quantitative easing will help avoid deflation. Defanging deflation may be more important to Bernanke, since a decline in prices makes consumers and businesses less willing to invest. Moderate inflation makes it easier for companies to make higher profits, which encourages them to spend more. A little inflation also encourages consumers: Everyone likes to see the value of their home rise.

56%

Bloomberg poll respondents who say the Fed's plan won't boost growth

Bernanke and other members of the Federal Open Market Committee, who have kept the central bank's target for overnight interest rates between banks near zero since 2008, "are happy to see that inflation expectations have moved up," says Stuart Spodek, a managing director at New York-based BlackRock, the world's biggest money manager.

Pushing inflation seems to contradict the Fed's dual goals of keeping rates low enough to spur growth while still promoting stable prices. The idea is to brew up enough inflation to help the economy while still keeping inflation-adjusted rates affordable. "Bernanke will be successful," says Fabrizio Fiorini, who manages $8 billion as head of fixed income at Aletti Gestielle SGR in Milan. "A rise in yields will create a virtuous circle that will be helpful for housing, consumer confidence, and probably employment."

Others disagree. On Nov. 15, 23 economists and former Republican policymakers asked Bernanke to drop his strategy. "The planned asset purchases risk currency debasement and inflation, and we do not think they will achieve the Fed's objective of promoting employment," said the group's letter. Its publication helped spark a Treasury selloff. Yields on 10-year Treasuries recently surged to 2.85 percent.

While the markets anticipate prices will pick up in a year, there's little inflation now. On Nov. 17 the government said the cost of goods and services excluding food and energy rose 0.6 percent in October from a year earlier—the smallest year-over-year gain since 1961. *—Liz Capo McCormick*

***The bottom line** Despite few signs of inflation now, bond options are anticipating a rise in prices. That would lower the risk of deflation settling in.*

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Trade

How Much Can Exports Help the U.S.?

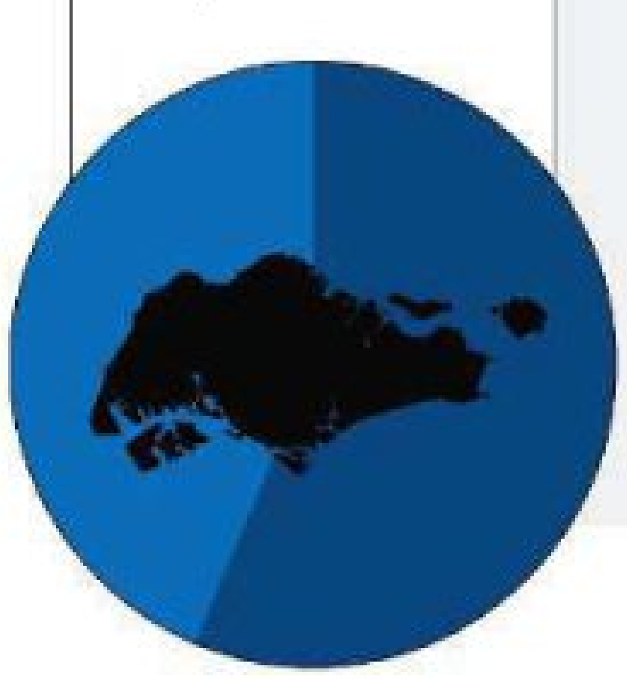
Exports of goods and services from the U.S. were valued at $1.6 trillion in 2009. Although in absolute terms that's a big number, it accounts for only 11 percent of U.S. gross domestic product. By comparison, German exports make up more than 35 percent of German GDP. At the end of the day, the U.S. is largely a domestic, continental economy, and what happens inside its borders will largely determine the strength of the recovery.

Singapore

156.4%

2009 exports as a share of GDP

Why such a large figure? Singapore exports its own manufactured goods. It also imports oil and other products from elsewhere and then re-exports them.



Germany

35.3%

Germany was for decades the world's top exporter and was only recently eclipsed by China. It is still the biggest exporter in Europe.



China

24.5%

China's reliance on exports makes it far more vulnerable to outside shocks and currency changes than the U.S.



United States

11.1%

Near the bottom of the pack for the major economies. Although the U.S. is the third-biggest exporter in the world, the huge domestic service economy is what counts.



Japan

10.7%

Although Japan is a major exporter, it still has a surprisingly large domestic economy. Last year exports were especially hard hit.



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DATA: CIA FACTBOOK

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Global Economics

Cotton farmers in China can't keep up with demand



China-U.S. Trade

Cotton is King Again, Especially in China

▶ Shortages are squeezing apparel suppliers

▶ "American consumers better get used to rising prices"

Gap, **J.C. Penney**, and other U.S. retailers have long benefited from low costs in China to hold down prices in their American stores. A cotton shortage may help change that equation.

China's farms produce about 26 percent of the world's cotton, yet that's not enough to satisfy the needs of the Chinese companies that make shirts, pants, dresses, and more for U.S. store chains. Cotton futures in China have surged more than 70 percent this year as the global economy emerged from recession and consumers worldwide started spending more on clothes. Production in China, the world's biggest user of cotton, is forecast to lag behind demand for a 12th year, cutting the country's stockpile to the smallest level since 1995, according to the U.S. Agriculture Dept. The shortfall gives local makers of cotton fabrics a lot of leverage in negotiating prices with apparel manufacturers. "It's a little terrifying to deal with cotton suppliers now," says Vicky Wu, a sales manager at **Suzhou Unitedtex Enterprise**, a closely held clothes maker based in Jiangsu province that counts Gap and Penney's among its clients.

Chinese suppliers to the big U.S. retailers have to figure out if they can pass on their increased costs. Unitedtex, which sells $24 million worth of shirts and jackets annually to Gap, plans to raise prices by 5 percent to 30 percent for products available in April, Wu says. **Shandong Zaozhuang Tianlong Knitting**, which makes **Polo Ralph Lauren** T-shirts and track suits for **Le Coq Sportif Holding**, has raised prices as much as 70 percent from a year earlier. "If cotton keeps rising like this, we will need to lift prices by 30 percent by Chinese New Year or we lose money," says sales manager Fred Hu.

"American consumers better get used to rising prices on the shelves of **Wal-Mart** and other retailers," says Jessica Lo, Shanghai-based managing director at China Market Research Group. "China's manufacturers are getting squeezed not only by rising cotton costs but also soaring real estate and labor costs." John Ermatinger, Gap's Asia president, declines to say whether Gap will raise prices. "We are going to be mindful of our competition," he says. "We are going to be mindful of our consumer. That's how we'll ultimately establish our prices."

—*Michael Wei and Luzi Ann Javier*

The bottom line *Chinese apparel producers are being squeezed by a shortfall in the cotton supply. The result could be higher prices in U.S. stores.*

Economic Literacy

Seinfeld and The Invisible Hand

▶ Econ profs use episodes of the show to teach about markets

▶ George looks for a substitute good; the Soup Nazi as monopolist

What is the deal with economics? You've got your costs and your benefits, your variables and your curves. And don't get me started about all the fractions!

What to do? According to a few economists, the answer is to watch *Seinfeld*. Earlier this year, Alan Grant of Baker University in Kansas, along with Linda Ghent and George Lesica of Eastern Illinois University, started a website based on the idea that the show was a rich primer on microeconomics. "*Seinfeld* is not about relationships," says Grant. "It's not about all of the mushy things. It's about four people who make decisions about how to act in certain situations. And that's what economics is all about."

The site, yadayadayadaecon.com, is the definitive source of

Tom Keene's EconoChat

Tom talks about the New York City market with top-selling real estate broker **Dolly Lenz** of Prudential Douglas Elliman

Let's steal something from Bill Gross and Mohamed El-Erian. What is the new normal for Dolly Lenz?
Well, the new normal in terms of sales volume is probably 25 percent less than the old normal. But fortunately, that's fine.

So we are not ready to say the worst is over?
New York City is the tale of two markets. The wealthy, well-to-do are buying everything in sight. Every apartment is setting a new record. On the low to middle end, those people need to sell another apartment to buy a new one. They need financing, need help in some fashion. This sandwich group is problematic.

Give me a dollar amount for what constitutes the low end for you.
A million, 2 million.

Are you seeing big foreign money at the high end in New York?
Right now there are probably three people from Russia bidding on properties in excess of $40 million and looking for others to bid on. It is beyond amazing.

Would real estate suffer dramatically if the mortgage-interest deduction were eliminated?
If you eliminate it, everyone has to recalibrate all their numbers because they are figuring out those numbers in the decision to buy vs. rent. So I think that is not good. And the psychological impact would be huge.



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

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Global Economics

Seinfeldian economic pedagogy, with descriptions of nearly 200 scenes and the principles each demonstrates. The famed Soup Nazi? He stands for monopoly power. His uniquely delicious soup keeps customers coming back even though he verbally abuses them. When Elaine comes into possession of his recipes after being banished from his shop, she threatens to challenge the monopoly.

Or take "The Sponge," an episode that Princeton economist Avinash K. Dixit has written an entire paper about. Hearing that her preferred brand of contraceptive sponge is being pulled from the market–creating scarcity–Elaine buys a case of them and begins to hoard her dwindling stash. She starts to think in terms of opportunity cost: Is sex with a current boyfriend worth giving up sex with a future date who might be better? Is he, as she puts it, "sponge-worthy"?

Ghent reports that her students say the show is a valuable aid. "They may never have met a Soup Nazi, but they can relate to being in a situation where someone has market power over them," she says. Plus, it's funny to read plot lines rendered in the deadpan language of the dismal science. For example: "When George joins a book club to impress a girl and finds the reading too costly, his demand for a substitute good (the video of the novel) rises to ridiculous proportions. In the end, he finds that the movie and the book are imperfect substitutes."

Seeing the show this way reveals how economics lies at the heart of its distinctive brand of humor. Jerry, George, Elaine, and Kramer are ruthless people who faithfully follow the rules of classical economics, even if they violate the dictates of decorum. In one episode, Jerry barters away the intellectual-property rights to one of his sexual techniques. Where the rest of us laugh and gasp, an economist would only nod in understanding. **B** —*Drake Bennett*

The bottom line *Several economists have set up a website that explains the behavior of Seinfeld and his pals in economic terms.*



Seven Days

Events of note in the week ahead

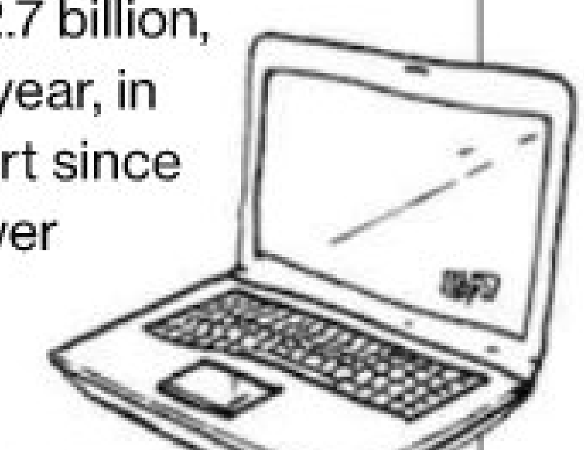
by Ira Boudway

22

France's Leading Economic Index

Chicago Fed National Activity Index for October

▶ **Hewlett-Packard earnings:** Analysts expect revenue of $32.7 billion, up $2 billion from last year, in the first quarterly report since Léo Apotheker took over as CEO.



23

U.S. third-quarter GDP

WTO Dispute Settlement Body meeting in Geneva



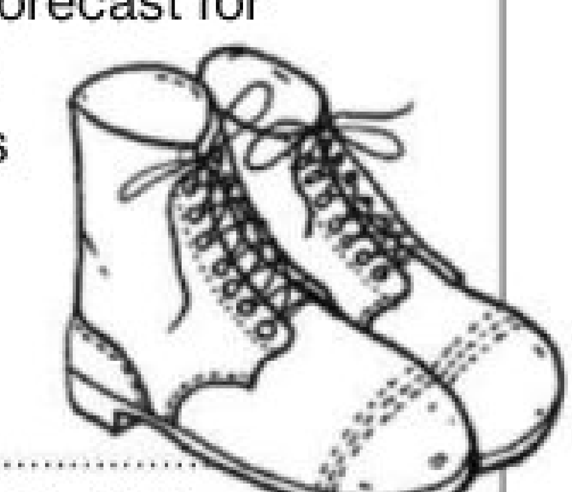
▶ **Annual Congress of the Confederation of German Employers' Assns.:** Speakers include Chancellor Angela Merkel. ▶ **Sarah Palin's book:** *America by Heart: Reflections on Family, Faith and Flag* lands in bookstores.

24

U.K. third-quarter GDP

Federal Open Market Committee minutes from Nov. 2-3 meeting

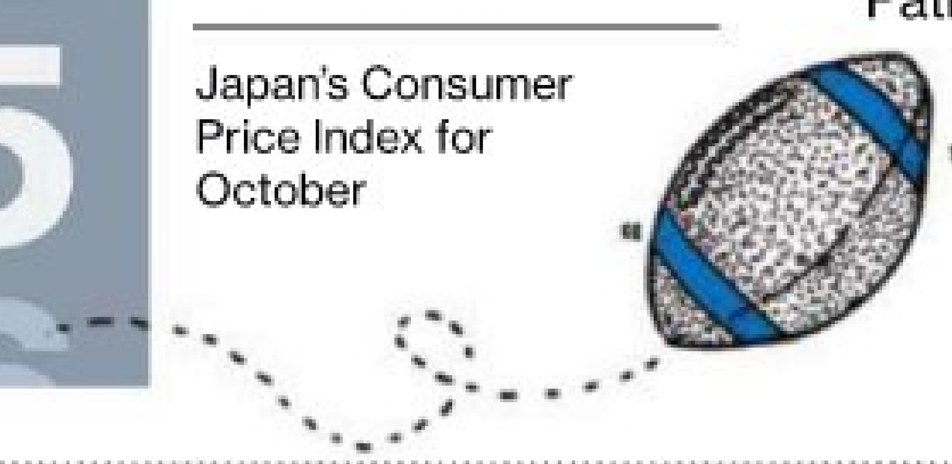
▶ **J. Crew earnings report:** The clothier cut its profit forecast for the year in August as increased promotions lowered earnings.



25

Brazil's unemployment rate for October

Japan's Consumer Price Index for October



▶ **Thanksgiving Day football:** The Patriots visit the Lions in Detroit; the Saints travel to Dallas; and the New York Jets host the Bengals.

26

France's unemployment number and consumer spending for October

▶ **Black Friday:** The biggest shopping day on the U.S. calendar saw $10.7 billion in sales last year, according to ShopperTrak.



27

College football: LSU at Arkansas

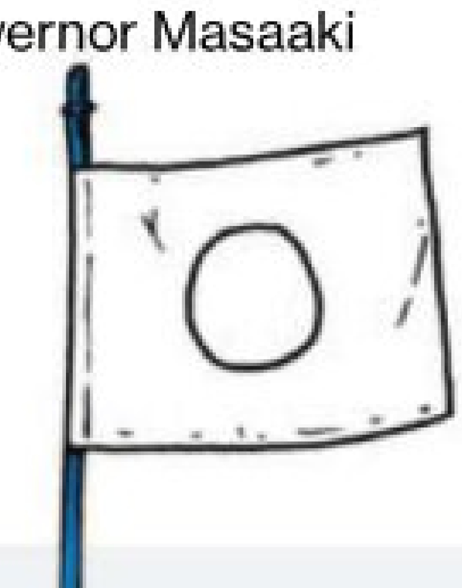


▶ **Small Business Saturday:** The debut of an initiative by New York City Mayor Michael Bloomberg and American Express CEO Kenneth Chenault to boost spending at local shops.

28

English football: Chelsea visits Newcastle United at St. James's Park

▶ **Bank of Japan:** Governor Masaaki Shirakawa speaks and holds a press conference at an economic forum in Nagoya.



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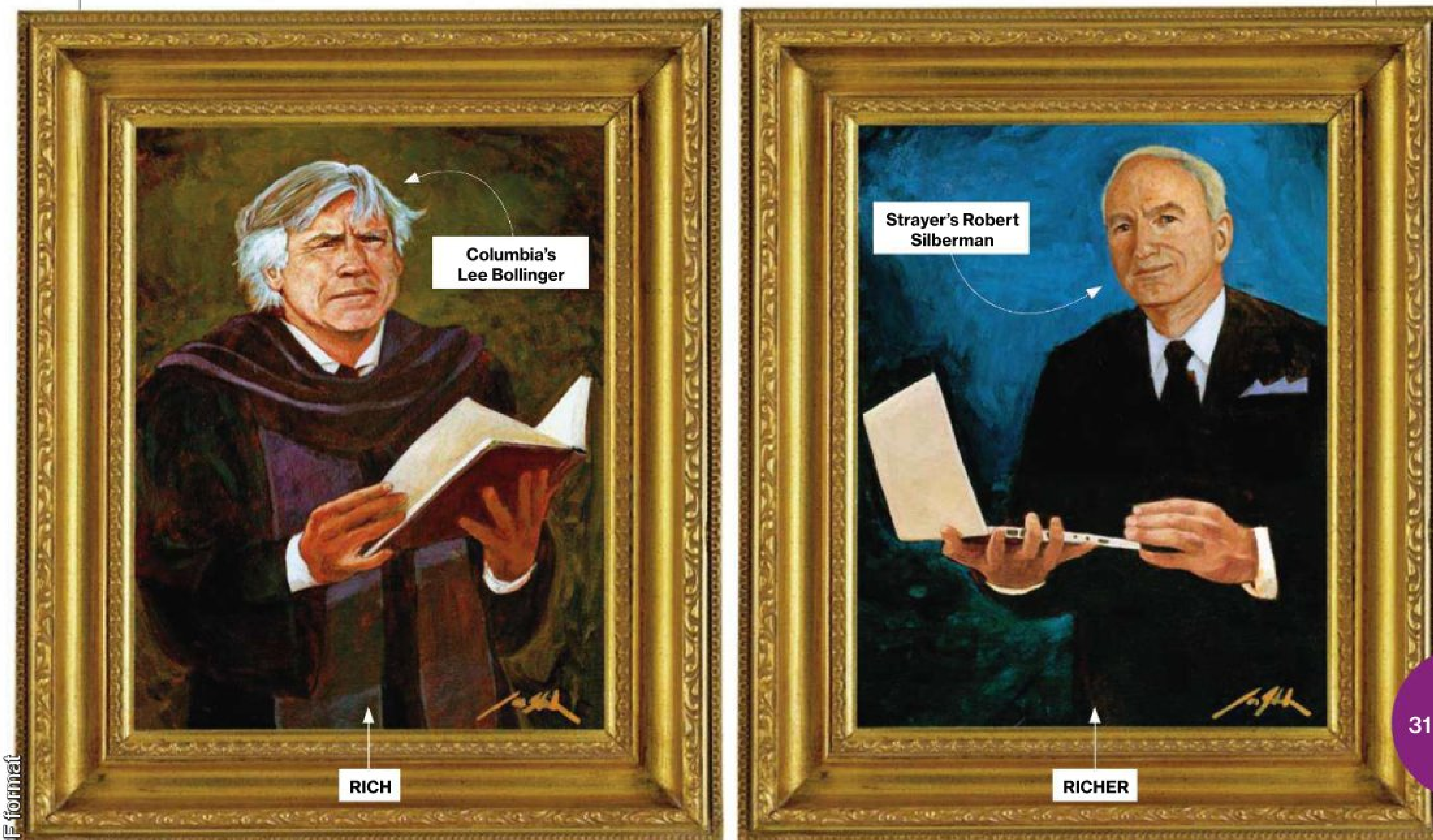
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Contents ▶ Bill Gates' crusade to eradicate polio 32 ▶ Frustrated in the U.S. luxury market, Audi wants a little respect 33 ▶ China can't slake its thirst for costly wines 34 ▶ Business Briefs 35 ● Edited by James E. Ellis



Pay Gap: Where For-Profits Beat the Ivy League

▶ **Executive compensation at for-profit colleges far outpaces that at traditional schools**

▶ **Online managers benefit from a "private enterprise that's almost entirely publicly funded"**

While for-profit colleges get poor grades for their high dropout rates, student loan defaults, and heavy dependence on federal student aid, their executives excel in another subject: making money. **Strayer Education**, a for-profit college chain that receives three-quarters of its revenue from U.S. taxpayers, paid Chief Executive Officer Robert Silberman $41.9 million last year. That's 24 times the compensation of the highest-paid Ivy League university president, Columbia University's Lee Bollinger, who received $1.75 million in 2008, including the value of housing and other benefits, according to a study published Nov. 14 by the *Chronicle of Higher Education*. Silberman's annual pay, including cash and stock-based compensation, would have ranked him eighth on a list of the highest-paid executives at the largest 1,000 U.S. companies, according to Equilar, an executive-pay researcher.

It's not just fat paychecks. Top executives at the 15 U.S. publicly traded for-profit colleges, the largest of which are **Apollo Group** and **Education Management**, also received $2 billion during the last seven years from the proceeds of selling company stock, Securities and Exchange Commission filings show. Since 2003, nine for-profit college insiders sold more than $45 million of stock apiece. Peter Sperling, vice-chairman of Apollo's University of Phoenix, the largest for-profit college, collected the most: $574.3 million.

For-profit education, which receives as much as 90 percent of its revenue from federal financial-aid programs, is a "private enterprise that's almost entirely publicly funded," says Henry Levin, director of Columbia University's National Center for the Study of Privatization in Education. Students at for-profit colleges are defaulting on loans at three times the rate of those at private, nonprofit schools, government data show. The graduation rate for first-time,

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Sarah Palin's food fight page 44 ▶

full-time candidates for four-year degrees at for-profit colleges is 22 percent, vs. 55 percent at state colleges and 65 percent at private nonprofit institutions.

Harris Miller, president of the Washington-based Association of Private Sector Colleges & Universities, which represents the industry, says for-profit college executives deserve to be rewarded because of their records as entrepreneurs and the performance of their companies' stocks. "These guys were in it for the long term," Miller says. "They believe in the sector. They weren't in it for a quick buck." Miller says default rates at for-profit colleges reflect the lower socioeconomic status of students, rather than the quality of institutions. Students, not colleges, apply for federal grants and loans to pay tuition and fees, so the companies aren't directly subsidized by taxpayers, he says. State and private universities also receive government money, while education companies pay taxes, reducing their cost to the public, he adds.

Some nonprofit college presidents aren't exactly clipping coupons, either. The highest-paid head of a private nonprofit school was Touro College's Bernard Lander. He made $4.8 million, mostly in deferred compensation and benefits, according to the *Chronicle*'s study of 2008 data (the latest available). Lander died on Feb. 8 at age 94.

The for-profits' setup as public companies explains some of the large compensation. At Strayer, Silberman received a $40 million stock grant in 2009 that vests over 10 years, says J. David Wargo, a Strayer director and former head of its compensation committee. After Silberman arrived, Strayer shares rose almost tenfold through 2009, when the grant was made, Wargo says. Silberman will forego the stock if he leaves the company before 10 years, he says.

To identify executives with the biggest gains from selling stock, InsiderScore.com, which analyzes insider transactions, compiled data for the seven years starting in July 2003. From the overall sum received from selling stock over the seven-year period, InsiderScore subtracted the value of open-market purchases and the cost of exercising options during that time frame.

The SEC is conducting an informal inquiry into Apollo's insider share sales, the company said on Oct. 26. The company said it's cooperating. John Sperling, Apollo's 89-year-old executive chairman and founder, and his 50-year-old son, Peter, have sold a combined $837.8 million in Apollo shares since 2003. Apollo spokesman Ryan Rauzon says the Sperlings have been diversifying their investments, selling during "open trading windows." On Nov. 1, Apollo said it would initiate a trading plan for the Sperlings that would further restrict the timing of stock sales. The father and son still hold about $750 million in Apollo shares, filings show.

Over half a century, Apollo's John Sperling, a former college professor, pioneered the for-profit college industry, including its use of online courses, Rauzon says. The "overwhelming majority" of the shares that John and Peter Sperling sold are founders' stock held for decades, he adds. "When you look at him as a founder and entrepreneur who has improved the lives of millions of Americans, that alone explains his compensation."

—John Hechinger and John Lauerman

The bottom line *The compensation of executives at for-profit colleges far outpaces that of managers at traditional universities.*

Institutions of Higher Learning—and Higher Pay

Executives at for-profit colleges are the most well paid in higher education. Here are the five with the largest total compensation in 2009, plus the Top 5 for stock sales since 2003.

CEO	COMPANY	TOTAL COMPENSATION[1] (MILLIONS $)
Robert Silberman	Strayer Education	41.9
Andrew Clark	Bridgepoint Education	20.5
Kevin Modany	ITT Educational Services	7.6
Charles Edelstein	Apollo Group	6.8
Daniel Hamburger	Devry	6.1

EXECUTIVE	COMPANY	TOTAL STOCK SALES[2] (MILLIONS $)
Peter Sperling	Apollo Group	574.3
John Sperling	Apollo Group	263.5
Robert Knutson[3]	Education Management	132.4
Rene Champagne[3]	ITT Educational Services	73.9
Robert Silberman	Strayer Education	70.4

[1]MOST RECENT FISCAL YEAR. INCLUDES SALARY, BONUS, STOCK, AND OPTION GRANTS. [2]GROSS PROCEEDS MINUS PURCHASES AND COST OF EXERCISING OPTIONS. [3]FORMER EMPLOYEE. DATA: EQUILAR, INSIDERSCORE.COM, SEC FILINGS

Health

Bill Gates Closes in On Polio

▶ The philanthropist gets drugmakers to lower vaccine prices

▶ "It's going to be expensive to travel the last mile toward eradication"

Bill Gate's eureka moment came in June 2009 in an underground conference room at the World Health Organization's headquarters in Geneva. After a decade of giving away millions to eradicate polio, the billionaire philanthropist was being briefed on hours-old data showing how two doses of a new polio vaccine protected 37 percent more children than conventional ones.

42.6%

Decline in polio cases globally over the past 12 months

The immunization, which protects against multiple strains, promised to speed the effort to wipe out the crippling killer that remains a scourge in developing nations. Several months later, Gates pledged an additional $285 million toward eradication of the malady.

Fast forward to early November, when Gates again stepped into the fight against polio. This time his charitable foundation helped broker a deal that will allow the UN to buy those new vaccines more cheaply. The **Microsoft** co-founder met with **GlaxoSmithKline** Chief Executive Officer Andrew Witty in New York this month as part of talks that resulted in five international suppliers–GlaxoSmithKline, Indonesia's **Bio Farma**, **Sanofi-Aventis**, **Novartis**, and New Delhi-based **Panacea Biotec**–agreeing to steep cuts in polio vaccine prices.

Under the deal the UN Children's Fund, known as Unicef, will pay a weighted-average price of about 13¢ apiece for the 2.4 billion doses it plans to buy in 2011 and 2012, down from 14.5¢. The price reduction reverses a decade-long trend of increases, according to Unicef. "The foundation can sometimes be a catalyst to bring parties to the table,

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Gates in Nigeria: His foundation has spent more than $1 billion to fight polio

and we saw that with Unicef and the manufacturers," Gates said in an e-mail. "The outcome was greater certainty and lower costs."

About 40 percent of Unicef's order will be for the new vaccine, which is bivalent, meaning it works against two types of polio. "We were all enthusiastic about the promise of bivalent to help us reach eradication, and to reach it sooner," Gates said in the e-mail. "We knew it had a good chance at eliminating the ping-pong effect we were seeing in taking on the different types of polio outbreaks."

The $60 million saved by the price-cuts will allow Unicef to buy up to an additional 400 million doses, says Bruce Aylward, head of WHO's polio program. "We have a real opportunity to give it our best shot to finish this with the new vaccines," he says. "The manufacturers are playing ball."

Polio, an acute viral disease, paralyzed millions of people worldwide in the 20th century. At the height of the most extensive polio outbreak ever in 1952, almost 60,000 cases with over 3,000 deaths reported in the U.S. alone. Polio was eliminated from the Western hemisphere after vaccines became widely available in the mid-1950s. Yet before the Global Polio Eradication Initiative began in 1988, the disease still paralyzed at least 350,000 children in more than 125 countries annually. Although outbreaks have been dropping fast in recent years, the malady still struck in 23 countries last year. India had the most cases.

Progress is being made: 85 vaccination campaigns in 2009 across India, Nigeria, Pakistan, and Afghanistan slashed the number of cases in those nations to 180 so far this year, from 1,051 the same time last year. Behind the success: the bivalent vaccine, first used commercially last December, in Afghanistan. Two doses of the new medicine, given as drops on the tongue, gave 86 percent of children protective antibodies against the most virulent kind of polio (no vaccine is 100 percent effective), according to a study in India. In comparison, a double dose of conventional vaccine protected 63 percent of kids from Type 1 polio.

The Seattle-based Bill & Melinda Gates Foundation has provided more than $1 billion for polio programs during the past decade, making it the biggest donor to a global three-year, $2.6 billion plan to root out the last vestiges of the disease by 2013. It would be the first viral illness in humans to be declared eradicated since smallpox in 1980. Nonetheless, the program faces an $810 million funding gap. "It's going to be expensive to travel the last mile toward eradication," said Jeff Raikes, the foundation's CEO, in September. "But it will be exponentially more expensive if we don't reach the end of the road, because we'd have to keep on treating thousands of children paralyzed each year indefinitely." —*Jason Gale*

The bottom line *Polio continues to plague the developing world. Microsoft co-founder Bill Gates is spending heavily to eradicate the disease.*

Autos

Audi: Taking a New Route in the U.S.

▶ The Volkswagen unit, long China's luxury leader, eyes U.S. growth

▶ "If you want to be a progressive brand, you have to be controversial"

During a family vacation driving up the California coast last August, **Audi** Chief Executive Officer Rupert Stadler was displeased by what he saw—or more precisely, didn't see—on the streets of America's most affluent neighborhoods. "I simply see too few vehicles with the four rings when I am driving on the highways there," Stadler says, referring to Audi's iconic logo. "We still have work to do."

That's a humbling realization for the brand that surpassed **BMW** and **Daimler**'s Mercedes-Benz in luxury sales in Europe last year. It's also been the luxury leader in China since its entry in 1988, three years after its parent, **Volkswagen**. Yet nearly two decades after its reputation in the U.S. took a hit over concerns its cars were subject to sudden acceleration, Audi only recently has started to regain traction in America.

4.96

MILLION

The number of viewers for the premier of *Sarah Palin's Alaska* on cable's TLC network on Nov. 14. It was a record series debut for the channel, though less than a third of viewers were in the coveted 25-54 age group.

DATA: NIELSEN

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The automaker's U.S. sales trail those of BMW, Mercedes, and **Toyota Motor**'s Lexus. True, Audi will sell more than 100,000 cars here for the first time this year and the carmaker aims to double that figure by 2018. Stadler needs a North American bounce to meet his ambitious goal of leapfrogging his German rivals to become the world's No. 1 maker of luxury cars by 2015. VW also is counting on Audi to remain a profit driver: The division's third-quarter return on sales hit 11 percent, besting BMW's automotive operating margin of 8.1 percent and Mercedes' 9.5 percent.

Stadler, who took charge four years ago, is spending 2 billion euros ($2.7 billion) annually to improve technology and introduce new vehicles. Audi will add six new models in the next five years, which could include a new small auto, compact sport-utility vehicle, and a sports car. The carmaker is also laying out millions to run quirky commercials during blockbuster events like the Super Bowl and Academy Awards.

Some trendsetters have taken notice: Celebrity Audi drivers include New England Patriots quarterback Tom Brady and his supermodel wife Gisele Bündchen, as well as Taylor Lautner from the *Twilight* films and Chace Crawford of TV's *Gossip Girl*. "Audi has a young, hip image—it's attracting a lot of young Hollywood types," says Rebecca Lindland, who tracks luxury carmakers at researcher IHS Automotive.

To boost Audi's awareness in the U.S., the carmaker in 2009 sponsored the evening newscasts on ABC, CBS, and NBC on President Barack Obama's inauguration day by buying out all the commercial time and showing a single ad for its A4 sedan. Its Super Bowl commercial this year featured the "Green Police," who arrest people for using plastic bags and Styrofoam cups. In the ad, an Audi A3 driver with a fuel-efficient diesel engine meanwhile zips past environmental roadblocks. Traffic on the brand's U.S. website for the compact car jumped 300 percent after the spot ran. The carmaker has also taken the unusual tactic of showing rivals in its ads, referring to them as "old luxury" while trumpeting Audi cars as "new luxury." "If you want to be a progressive brand, you have to be controversial at times," says marketing chief Peter Schwarzenbauer, who previously worked for **Porsche** and BMW in North America.

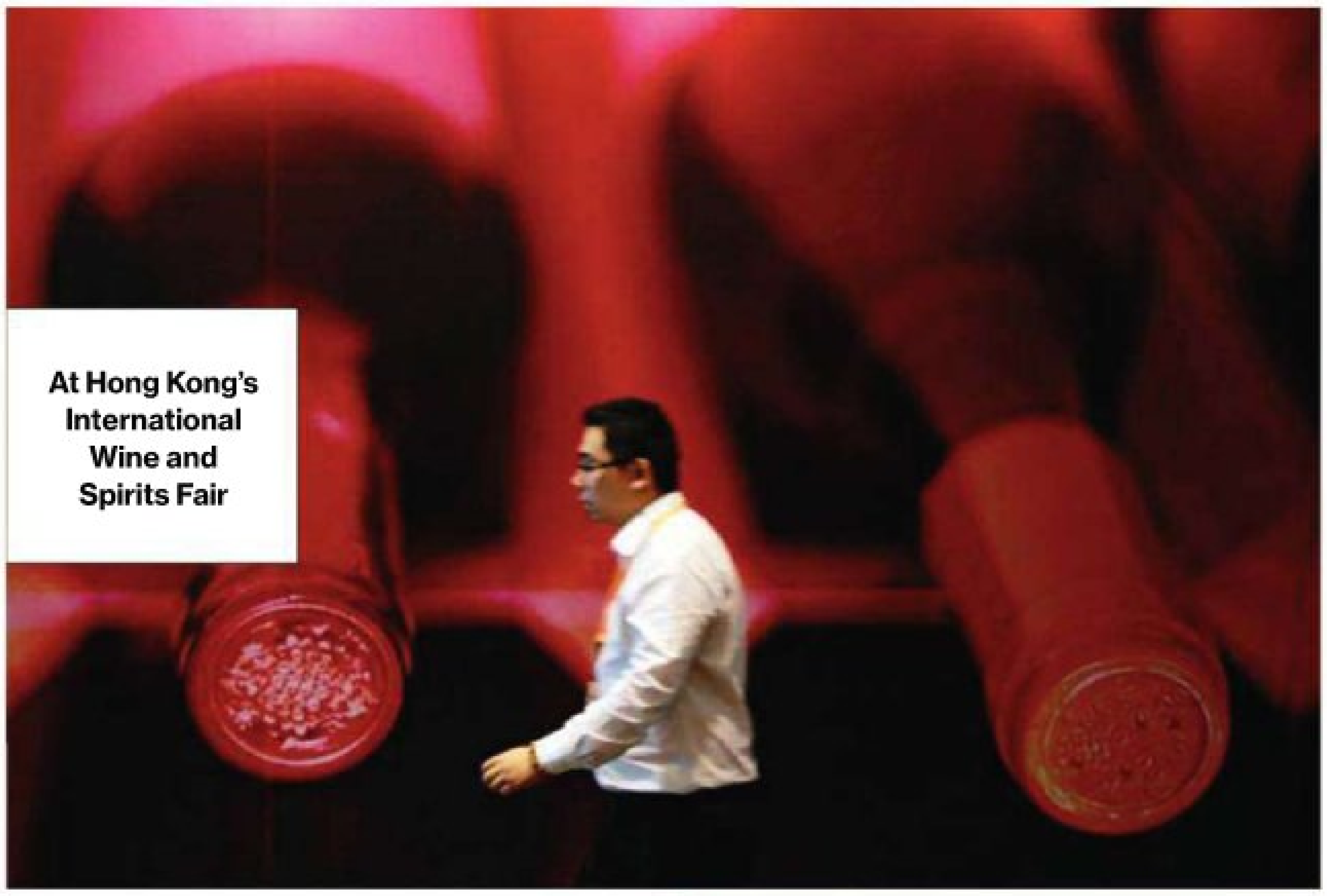
Still, Audi has a long way to go. Its U.S. sales through October were less than half those at each of its three main luxury rivals. Audi's average U.S. selling price in October of $45,185 also trailed BMW's $51,315 and Mercedes $61,340, according to market researcher Edmunds.com. Nonetheless Audi has chopped average U.S. incentives in half since 2007, to just $995 last month. Mercedes offered $3,712 in October, BMW $2,706, and Lexus $2,607. "You can't be No. 1 in the world without being successful in the U.S.," says Schwarzenbauer. "'If you can make it here, you can make it anywhere,' is still valid for me."

—*Chad Thomas and Andreas Cremer*

The bottom line *Volkswagen's Audi brand, the luxury car leader in both China and Europe, is aggressively moving to boost sales in the U.S.*



The R8: Audi's bold styling is catching the eyes of younger, hipper drivers



At Hong Kong's International Wine and Spirits Fair

Wine

Waiter, Another Pricey Bottle of ... Whatever

▶ China's wealth has made Hong Kong a mecca for buyers of costly wines

▶ "That's not investment. That is just uncontrolled spending"

He Wei Qi, a businessman from eastern China's Zhejiang province, says he routinely pays more than 30,000 yuan ($4,500) for a bottle of wine to entertain guests. "A price tag of more than a million yuan a bottle—that does more than show off your wealth, it shows you have good taste," said He, 38, while attending a three-day Hong Kong wine and spirits exhibition that drew about 700 companies from 29 countries. "We don't care how outrageously expensive the wines are."

The value of wine auctions in Hong Kong reached $120 million this year, almost double the $64 million in 2009 and four times the amount generated before the city cut duties on wine to zero two years ago, according to local auctioneers. **Sotheby's** and **Christie's International** say their auctions of wine in Hong Kong will raise more than sales in New York and London combined this year. Sotheby's had to issue tickets for the first time for its Oct. 29 wine auction, when it offered almost 2,000 bottles of Lafite shipped directly

FROM TOP: YM YIK/EPA/CORBIS; CHIP CHIPMAN/BLOOMBERG. OPPOSITE PAGE, CLOCKWISE FROM TOP: CASPER HEDBERG/BLOOMBERG; TED S. WARREN/AP; PAOLO FRIDMAN/BLOOMBERG

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from the Bordeaux chateau's cellars. The sale beat the auction record for a single bottle set in 1985 in London, when publisher Malcolm Forbes paid 105,000 pounds ($169,000) for a 1787 vintage. At the Oct. 29 auction, three bottles of Château Lafite's 1869 vintage each sold for a record $230,000, 28 times Sotheby's top estimate before the auction. "What we've seen emerging in the last year are people paying virtually any price for wine," said David Elswood, Christie's London-based head of wine. "That's not investment. That is just uncontrolled spending."

Chinese collectors in Hong Kong, the mainland, and Taiwan now hold about one in four bottles of fine or rare vintage wine globally, according to **Crown Wine Cellars**, which stores about HK$1 billion of wine in a network of converted ammunition bunkers in Hong Kong. Asia's wine market will expand four times faster than the rest of the world, said Robert Beynat, chief executive of wine exhibition organizer **Vinexpo Asia Pacific**. Much of the growth will come from mainland China, the final destination of much of the fine wine sold in Hong Kong, he said. Liu Xue Biao, a wine merchant from Shenzhen, said that wine he buys in Hong Kong for $3 a bottle can be sold on the mainland for 300 yuan, a 1,400 percent markup. "They are willing to pay just about any price," said Liu, accompanied by two assistants carrying suitcases for their purchases.

Imports by Hong Kong merchants jumped to $600 million in the first nine months of 2010, more than all of last year. China's surging wealth—its number of billionaires soared by 60 percent in the past year—is "inflating a bubble" in wine, said Christie's Elswood. "When you're paying four, five times or even more than the reference price then you have to seriously question the market knowledge of that buyer." One example: At Sotheby's Apr. 3 auction in Hong Kong, a 12-bottle lot of Château Latour 1982 fetched $43,649. Two weeks later, New York-based Tribeca Wine Merchants ran a newspaper ad offering the same for $2,250 a bottle, or 38 percent less.
—*Hanny Wan and Wendy Leung*

The bottom line *Fast-growing wealth in China is boosting demand for fine wine sold in Hong Kong. That's raised fears of a wine price bubble.*

Briefs

by Caroline Winter

Volkswagen
A bigger maker of big rigs



Volkswagen is exploring a merger of its Swedish truck-making unit, Scania, with Munich-based MAN. A deal would create Europe's largest manufacturer of heavy trucks and buses, surpassing both Volvo and Daimler. VW owns 46 percent of Scania and 30 percent of MAN. To increase its stake in Scania, it may transfer its MAN shares to the Swedish company, according to German weekly *Der Spiegel*. Scania could then offer to buy out other MAN investors. If joined, Scania and MAN would hold nearly 30 percent of Europe's market for big rigs and buses. Globally, the companies have sold a total of more than 84,000 vehicles this year.

Wal-Mart
As U.S. sales stall, an overseas lift



The world's largest retailer reported a 9.3 percent gain in third-quarter profit as growth overseas helped make up for a 1.3 percent dip in sales at U.S. stores open at least a year. Wal-Mart Stores, which has suffered six straight quarters of stateside sales declines, is expanding its product lineup and planning smaller outlets in hopes of winning back struggling U.S. consumers. Sales abroad rose 7.9 percent, while total revenue increased 2.6 percent to $102 billion.

Phusion Projects
Waking up to the peril of energy drinks

Alcoholic energy drinks such as Four Loko, Joose, and Moonshot will be effectively banned in the U.S. following reports that young people have been hospitalized after consuming them, Senator Charles Schumer (D-N.Y.) says. After a yearlong review, federal agencies found that combining caffeine and alcohol is unsafe, as the stimulant masks the effects of the liquor, increasing the risk of alcohol poisoning. In response, Phusion Projects, maker of the popular Four Loko brand, announced that it will remove caffeine from its brew.



Gazprom
A new Cuban connection

30%

Russian energy giant Gazprom has signed an agreement with Malaysia's Petronas to buy a 30 percent stake in a project to drill for oil off the coast of Cuba in the Gulf of Mexico. Exploratory drilling is scheduled for 2011 but still requires approval from Cuban authorities, according to Gazprom. The Russian company is seeking to expand abroad—in Venezuela, Equatorial Guinea, and Iraq—as it aims to almost double output to 2 million barrels a day by 2020. Some of the Cuban oil fields lie just 50 miles away from Key West, Fla.

Intel
Coming soon to TV: Intel Inside

Intel says it's working with "several" global television makers to introduce models built with its chips. As demand for Internet-linked TVs grows, the company—whose processors are in about 80 percent of the world's personal computers—plans to introduce a TV chip early next year. The company says it might display some of the new models at the Consumer Electronics Show in Las Vegas in January. Intel faces stiff competition. In October, Sony introduced Internet-enabled TVs using Google software. A month before that, Apple released a $99 TV set-top box that delivers movies and TV shows from the Web. Samsung, the world's largest TV maker, says it's open to using Intel's chips.

On the Move

Burger King **Bernardo Hees appointed CEO** ● ***Newsweek*** **Tina Brown named editor-in-chief of Newsweek Daily Beast Co.** ● **Fannie Mae** **CFO David M. Johnson to resign at year's end**

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Contents ▶ The largest job-bias case ever knocks at the Supreme Court's door 39 ▶ The business lobby as stealth media mogul 40 ▶ Wanted in Iraq: 7,000 State Dept. contractors 42 ▶ China, a convenient foil for Obama 42 ▶ Sarah Palin takes on Michelle Obama's favorite cause 44 ● Edited by Paula Dwyer

Politics&Policy

Guess Who's Running To Obamacare's Rescue?

▶ **The health-care industry wants to fend off GOP efforts to kill insurance mandates**

▶ **Keeping the mandate "is the No. 1 lobbying issue in the insurance industry right now"**

When the White House and Democratic lawmakers wrote the health-care overhaul bill, they concocted a sweet coating for the bitter medicine the health industry would have to swallow. In exchange for tighter regulation and numerous new directives, insurers, drugmakers, hospitals, and physicians got some 30 million new paying customers under the individual mandate requiring almost everyone to buy insurance starting in 2014 or pay a fine.

The individual mandate is now under attack in the courts and on Capitol Hill by Republicans, libertarians, and Tea Party enthusiasts who call it an affront to personal liberty. The industry, however, views it as the bedrock supporting the entire health reform law and is lobbying to keep it. The prospect of a vastly bigger market has helped spark a 7.4 percent rise since Jan. 1 in the Standard & Poor's 500 Managed Health Care Index of publicly traded health-care companies.

For insurers, eliminating millions of potential customers while keeping other aspects of the overhaul would be a "nuclear nightmare," says Robert Laszewski, president of Health Policy and Strategy Associates, a consulting firm that works with insurers. It would leave insurers without the extra revenue to cover higher costs from the law's ban on the denial of coverage to people with pre-existing conditions or charging sicker patients higher premiums. "It's the No. 1 lobby issue in the insurance industry right now," says Laszewski.

At the same time, some industry groups are worried that Republican plans to undo the centerpiece of the law, which President Barack Obama signed in March, could unravel other backroom deals they cut with the White House, forcing them to fight



ILLUSTRATION BY SOPHIA MARTINECK

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costly legislative battles all over again.

Drugmakers, for example, agreed to pay $80 billion in taxes over 10 years and give discounts to help the elderly pay for drugs. In return, the manufacturers are guaranteed millions of new customers. The White House and Senate Democrats also arranged not to allow the Medicare program, which covers the elderly and disabled, to negotiate drug prices, as do most state Medicaid programs that cover the poor. Additionally, the Administration agreed to continue blocking the re-importation of drugs from Canada. Some lawmakers in both parties favor re-importation, and the pharmaceutical industry adamantly opposes it. Both deals help drugmakers fend off pressures to lower prices. Hospitals, drug and device makers, and doctors also stand to benefit from the law's expansion of Medicaid coverage to 16 million more people by 2017.

Republicans have already proposed alternatives to the mandate that put less emphasis on covering the uninsured. Their plan, offered by soon-to-be Speaker of the House John A. Boehner of Ohio, has no individual mandate, allows people to buy coverage across state lines, and would cover just 3 million people, according to the Congressional Budget Office.

Republicans traditionally have supported the insurance industry, but the Tea Party's success in redefining the debate in Washington has changed the equation, says Laszewski. Democratic ranks were also thinned in the recent midterm elections that, in many districts, turned on voter distaste for the health law. Now, neither party may be happy with the individual mandate. "It's hard to find a provision with more bipartisan opposition," says Doug Badger, a lobbyist and partner with Nickles Group, which counts Philadelphia-based insurer **Cigna** among its clients. Says Thomas P. Miller, a health-care fellow at the American Enterprise Institute: "When you pull that mandate apart from the rest, you have to wonder why you're doing all those other things."

Cigna Chief Executive Officer David M. Cordani has said he does not think it's in the country's best interest to repeal the law or pull out specific provisions. "It's a dangerous path to remove individual components from the law without understanding the impact," he said in a Nov. 9 PBS television interview.

The insurance mandate, though, is more than just a policy issue for some Republicans. It's an assault on the Constitution. In the Senate, for instance, Utah Republican Orrin G. Hatch, the current ranking member of the Judiciary Committee, called the mandate "an astonishing expansion of federal power and busts the limits that the Constitution imposes on the federal government."

In the House, Republican Representative Eric Cantor of Virginia, who will be House Majority Leader in January, "is not supportive" of the mandate, according to John Murray, his communications director. "The individual mandate is something the insurance industry is hyperfocused on," Murray says. "They feel they've got to have that to be successful. Our team is not supportive of that. We don't like mandates."

While Democrats who backed the law might now seem a more natural ally in defending the mandate, issues exist there as well. Insurers just spent $1.1 million funding opponents to Democratic campaigns. Now they will have to count on many of those same Democrats to defend them. Some may not. Joe Manchin, the Democratic senator-elect from West Virginia, called the mandate "far overreaching" during his campaign. The U.S. shouldn't "mandate and dictate" how people act, he said. Manchin did not respond to requests for comment.

The one thing going for the individual mandate may be political gridlock. Next year's split in Congress between Democrats who control the Senate and Republicans who will control the House could lead to a standoff that results in little change. Republican efforts to roll back the law over the next two years could be a table-setter for the real push to come after the next election, says James C. Capretta, a health-care fellow at the Ethics and Public Policy Center, a Washington think tank. "The decisive battle on the overhaul is likely to be the 2012 Presidential contest; that's what everyone's preparing for."

—*Drew Armstrong*

The insurance mandate is "an astonishing expansion of federal power," says Utah Republican Hatch

4.25

MILLION

The Federal Reserve's estimate of total U.S. home foreclosure filings in 2011 and 2012

CONGRESSIONAL TESTIMONY PREPARED FOR NOV. 18 DELIVERY BY FED GOVERNOR ELIZABETH DUKE

The bottom line *As Republicans take aim at the individual mandate in the health reform law, health-care industry groups are lobbying to preserve it.*

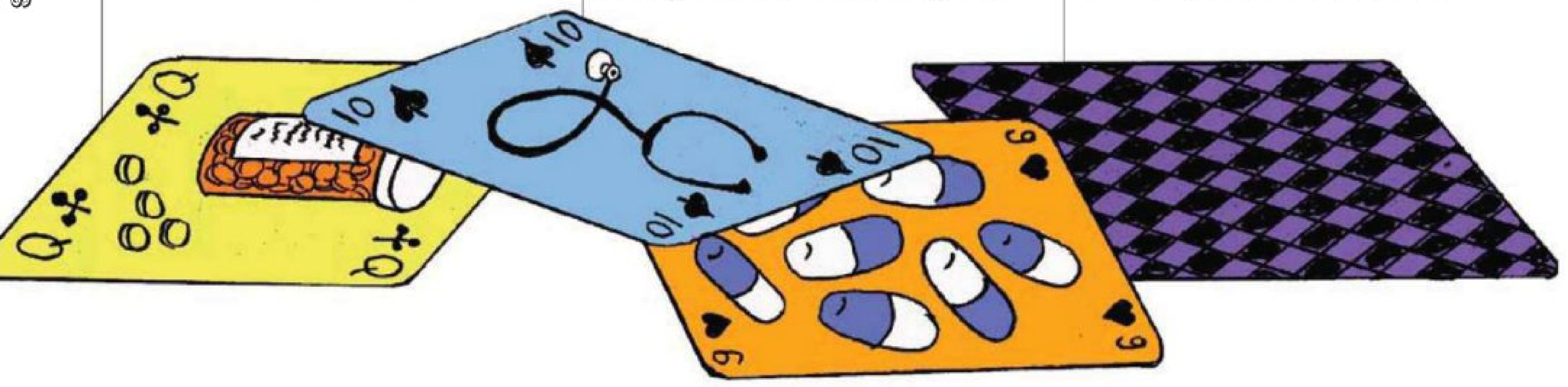
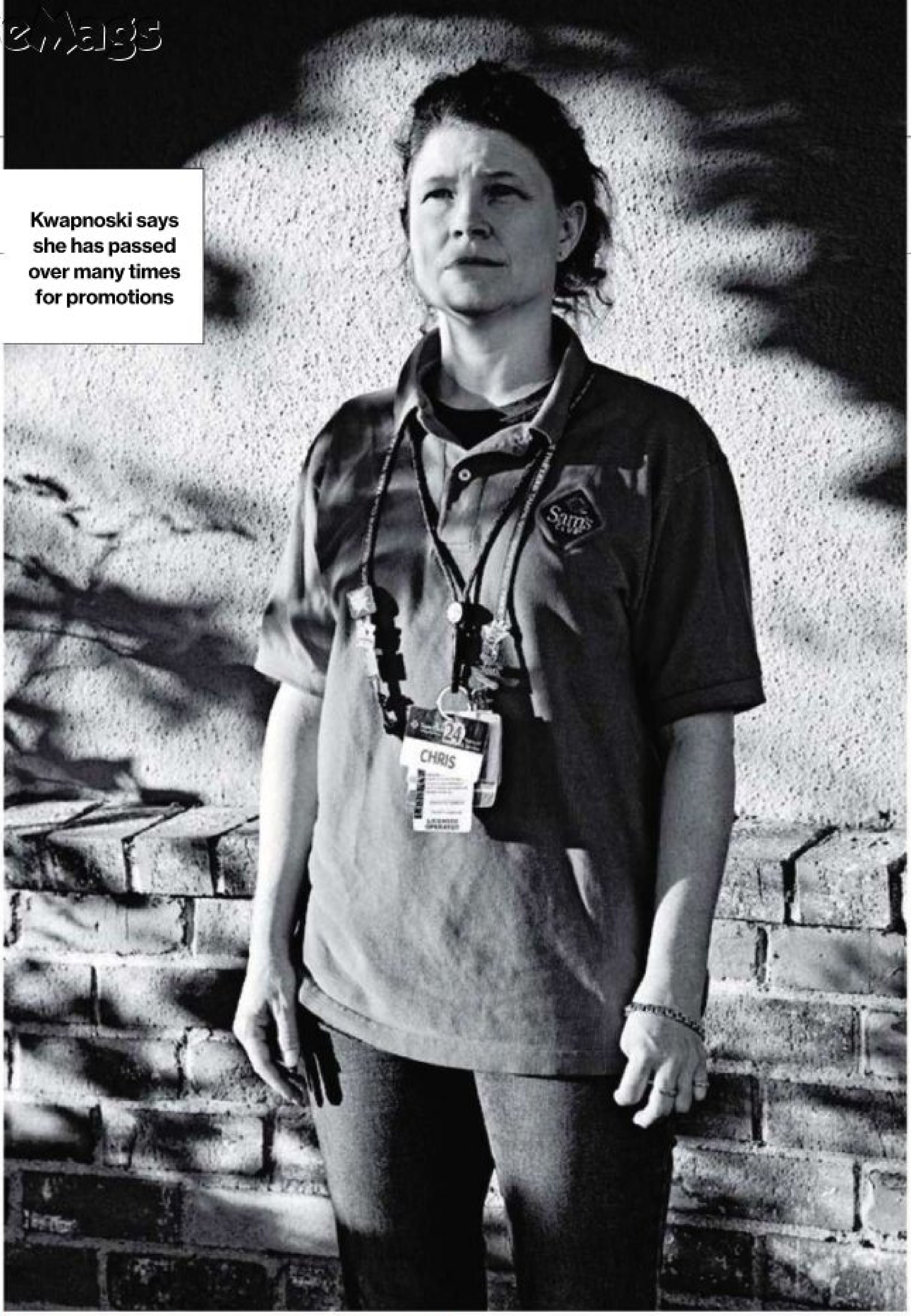


ILLUSTRATION BY SOPHIA MARTINECK; PHOTOGRAPH BY DRU DONOVAN FOR BLOOMBERG BUSINESSWEEK

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Kwapnoski says she has passed over many times for promotions

Supreme Court

Wal-Mart vs. a Million Angry Women

▶ The retailer wants the Roberts court to block a huge gender-bias suit

▶ "Blow the cobwebs off your makeup and doll up"

Chris Kwapnoski says she watched for 15 years as one male colleague after another leapfrogged over her into management jobs at the **Sam's Club** in Concord, Calif. When Kwapnoski asked a supervisor what was holding her back, she recalls getting a curt reply: "Blow the cobwebs off your makeup and doll up."

Kwapnoski's lawyers say her experience is common–so common that they are seeking to sue **Wal-Mart Stores**, which owns the Sam's Club chain, for discrimination on behalf of more than a million female employees. The suit would be the largest job-bias case ever against a U.S. employer. Wal-Mart is seeking a Supreme Court hearing, and the dispute could become the most important business case of the court's nine-month term. It's an "800-pound gorilla," says Robin S. Conrad, who heads the U.S. Chamber of Commerce's litigation unit.

The high court will say as early as Nov. 29 whether it will review a ruling by a San Francisco-based federal appeals court, which in April let the case go forward as a class action for women working at the company since 2001. (The original lawsuit was filed nine years ago on behalf of six women.) The company, which has 4,400 Wal-Mart and Sam's Club stores, says a case involving that many workers would be so unwieldy it would violate the Constitution's due process protections, including the company's right to defend itself against the charges. The plaintiffs' legal fight has become a business unto itself, involving seven law firms and several million dollars in expenses. Lawyers built their case in part through online surveys that female workers submitted on a website devoted to the litigation.

The class action would be the most important business dispute of the Supreme Court's nine-month term

The court, with a conservative majority led by Chief Justice John Roberts, has made little secret of its skepticism for what it views as lawyer-driven litigation. The court has already trimmed the federal securities fraud laws and required more specificity from plaintiffs when they file complaints. The Roberts court is "skeptical of litigation as a policy tool," says Jonathan Adler, a business law professor at Case Western Reserve University.

As a testament to its significance, 19 companies, including **Altria Group**, **Bank of America**, **General Electric**, and **Microsoft**, are urging the court to take up the appeal. The companies say the lower court ruling makes it too easy for workers challenging employment practices to secure class-action status and then extract large settlements. Even with meritless claims, "class certification decisions are often tantamount to a decision on the merits," the companies say in a court filing. Several companies have concrete stakes in the outcome. A suit on behalf of more than 700 women against **Costco Wholesale** is on hold until the Supreme Court resolves the Wal-Mart case. Altria and other tobacco companies say the Wal-Mart case may affect their challenge to a Louisiana court order requiring them to spend more than $270 million on a smoking cessation program.

For Wal-Mart, the case could mean billions in damages, though the lawyers for the women haven't specified how much they are seeking. A multibillion-dollar award would be a blow, but one Wal-Mart could absorb. The world's largest retailer had more than $400 billion in sales and $15 billion in profit over the past 12 months.

The complaint says women working for Wal-Mart have been

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paid less than men for the same jobs and received fewer promotions. Instead of posting management openings, Wal-Mart relied on a "tap on the shoulder" system that let managers steer jobs to male colleagues, says Joseph Sellers, a partner in the Washington-based law firm of Cohen, Milstein, Sellers & Toll who represents the women. "Wal-Mart's promotion system departed very substantially from what virtually every other large company at this time was doing," he says.

Wal-Mart, with 1.4 million U.S. employees, says any problem was isolated. Letting the case go forward would deprive the company of its right to contest the claims of each woman individually, says Theodore Boutrous, a partner with the Los Angeles law firm Gibson, Dunn & Crutcher who represents Wal-Mart before the Supreme Court. "To assume that every employee has been subject to discrimination flies in the face of the facts and really subjects the company to an extraordinarily unfair process," Boutrous says. The company says it now posts management openings.

The women will press ahead, possibly in a series of smaller class actions, if the Supreme Court rules against them, Sellers says. Kwapnoski, for one, is eager to focus public attention on her employer's treatment of female workers. Now an assistant manager, the 46-year-old says her $60,000 salary is less than half what she might be earning had she been promoted in step with her male peers. "I really, honestly would like to change the public's view of Wal-Mart," she says.

—Greg Stohr

The bottom line *Wal-Mart isn't the only company with a lot at stake in a gender-bias suit the Supreme Court will soon decide whether to hear.*

Law

The U.S. Chamber's Stealth Media Empire

▸ **The business lobby adds a fourth journal tracking civil suits**

▸ **A critic calls it an effort "to dupe the public and tamper with juries"**

The U.S. Chamber of Commerce, in a stroke of good timing, launched an online site covering civil lawsuits in Louisiana just weeks before the blowout on **BP**'s oil rig spawned thousands of lawsuits in the state. The lobbying group wants to draw attention to court districts it deems hostile to business.

The New Orleans-based journal will monitor civil suits against BP

The online journal, the Louisiana Record, doesn't disclose the Chamber's ownership on its site.

The Louisiana Record was launched in March, says publisher Brian Timpone. And it's the fourth such publication that the Chamber's Institute for Legal Reform has backed. "We do this assessment of how much civil litigation there is vs. the norm," Timpone says. "In places where there's more cases filed than the norm, we go cover the civil lawsuits."

The other Chamber-owned journals are in Madison County, Ill., Charleston, W. Va., and Beaumont, Tex.—all cited in an Institute study this year for having among the worst legal climates for business. New Orleans was already on the list in August when a panel of federal judges consolidated hundreds of claims there related to the Deepwater Horizon explosion and oil spill.

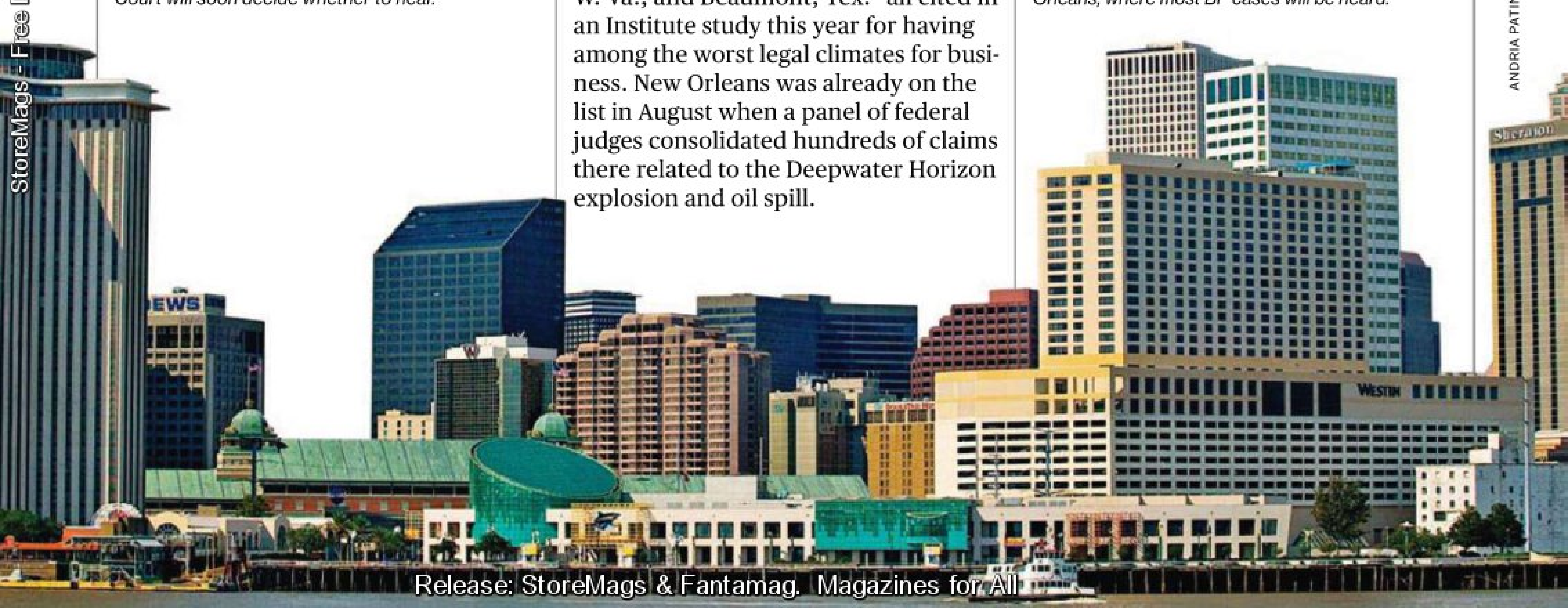
The Institute's website says it was created to "neutralize" trial lawyers' "excessive influence over the legal and political systems." The Institute had a budget of $41.7 million in 2008, according to its IRS filings. It spent $16.8 million on lobbying this year, says the Center for Responsive Politics, a nonpartisan watchdog. "The Chamber is one of the most politically active entities in the nation," says Dave Levinthal, a spokesman for the center. "It doesn't certainly have a history of sitting back and just calling balls and strikes."

The Louisiana Record's stories on civil cases have headlines that say: "Worker claims boss compared her to his wife," and "Supreme Court to decide statute of limitations on Katrina litigation." The "About Us" section says "This year, Louisiana's courts were ranked among the most unfair in the nation, according to a survey (Harris Interactive) of top corporate lawyers and business executives." The Harris survey was paid for by the Institute.

The website is an effort "to dupe the public and tamper with juries," says Ray De Lorenzi, director of communications for the American Association for Justice, a trial lawyer trade group. "The Chamber believes that the way to control public opinion is to take control of the media." Timpone says the legal journal is editorially independent and not designed to trumpet the Chamber's message. "The whole goal of this endeavor is to make sure that people know what's happening at the courthouse."

—Alison Fitzgerald


The bottom line *The U.S. Chamber is keeping close tabs on civil lawsuits with a new legal journal in New Orleans, where most BP cases will be heard.*



ANDRIA PATINO/CORBIS

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The making of Zynga's CityVille page 47 ▶



Iraq War

The Diplomats Muster An Army of Their Own

▸ State Dept. officials are preparing to run their own security

▸ "I worry a great deal about that transition"

The State Dept. has 13 months to field an army and an air force.

When the last of the 50,000 U.S. troops in Iraq pulls out at the end of 2011, the 1,100 civil servants who will stay behind will be in charge of their own security, responsible for running their own fleet of aircraft, and even operating a rocket-warning system.

They will be assisted by as many as 7,000 contractors who will train the Iraqi police force and provide protection for American civilians overseeing reconstruction in a country that averages 15 insurgent attacks a day. "I worry a great deal about that transition," says Ryan Crocker, U.S. ambassador to Iraq between 2007 and 2009. "The capacity does not exist on the civilian side to take on the vast array of roles and missions" the military performed.

U.S. forces now protect the American embassy in Baghdad—the world's biggest—with a counter-mortar and rocket system that lets them fire back at insurgents. Outside the capital, American diplomats and civilians advising on electricity projects and hospitals are housed, fed, and protected by American troops and are shuttled around the country on military aircraft. To prepare for the departure of the military, the State Dept. is assembling a fleet of aircraft, soliciting qualified trainers for the Iraqi police, and preparing to double the number of private contractors from companies such as **DynCorp International** and **Triple Canopy**, both of which are already in Iraq. Eight companies will compete for $10 billion of State Dept. security business over five years in Iraq, Afghanistan, and Pakistan. "Am I worried? Yes," says Undersecretary of State Patrick F. Kennedy, who's handling the transition. "Do I feel we will be ready? Also, yes."

Howard Berman, the California Democrat who until January serves as chairman of the House Foreign Affairs Committee, has summoned State Dept. and Pentagon officials to a hearing, set for Nov. 18, on the handover. "I want to be reassured that State's transition plan can work effectively. If it can't, we need to know now," Berman said in an e-mail.

After the troops depart, President Barack Obama hopes to be able to point to a democratic and prosperous Iraq as an example to the Arab world. He also is counting on it to provide a regional counterweight to Iran. American economic interests are at play as well: Iraq's crude oil reserves are the world's fifth-largest, and U.S. diplomats may have a role in deciding how to divide the oil revenue among feuding factions.

Already, Congress has proposed cutting $150 million to $425 million from Obama's request for $1.8 billion for the State Dept.'s operations in Iraq this year. Some lawmakers "really want to push down anything to do with Iraq and remove this burden as soon as possible," says Iraq's ambassador to Washington, Samir Sumaida'ie. "That's dangerous." *—Viola Gienger and Flavia Krause-Jackson*

The bottom line *The State Dept. is hiring thousands of contractors to help it assume duties in Iraq once the last of the troops departs in a year.*

U.S.-China Relations

Obama Finds China A Convenient Foil

▸ The President cites China as a model as much as a threat

▸ Competition with China makes it "hard for Republicans to say no"

President Barack Obama left the Group of 20 summit in Seoul without persuading China to let its currency float more freely or take steps to trim its trade surplus. However, in recent months, Obama has been citing China more as a model than a threat. It turns out that the high-speed Chinese economy is a good foil for a politically challenged President.

Whether the subject is education, infrastructure, clean energy, or high tech, Obama often points to China's investments and warns that the U.S. must do the same or fall behind. "We should be able to agree now that it makes no sense for China to have better rail systems than us," Obama said at a news conference the day after the midterm elections. "And we just learned that China now has the fastest supercomputer on earth. That used to be us." In an Oct. 26 address to Democratic donors in Rhode Island, the President criticized Republican budget plans that he said would cut federal education funding by 20 percent. "Do you think China is cutting it by 20 percent?" he asked. "They're playing for first place, and we need to play for first place." Charles Freeman, a China specialist at the Center for Strategic and International Studies, says the Administration recognizes the value "of a near-peer competitor, both for domestic purposes and to focus foreign policy."

Obama and Chinese President Hu Jintao met face-to-face for the seventh time at the G-20 confab. They next meet in Washington in mid-January—the exact date has not been announced—when Obama hosts Hu for an official visit, complete with formal state dinner.

They'll have plenty to talk about. China's trade surplus with the U.S. totaled $201 billion through September, more than the next seven largest U.S. trading partners combined, according to the Commerce Dept. That trade gap, a drop in American manufacturing jobs, and the White House's contention that the yuan (which has gained 3 percent since a two-year peg to the dollar ended in June) is undervalued have made China a target for Congress.

At the same time, Obama has new hurdles to getting his agenda enacted, including spending on education, research, and infrastructure, following elections that handed Republicans control of the House next year.



RON SACHS/BLOOMBERG

China is a good rallying issue as Obama pushes his spending plans, says Wendy Schiller, a political science professor at Brown University: "It's going to be hard for Republicans to say no when you mention competition with China."

Obama's predecessors used similar tactics, says H.W. Brands, a history

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WHAT WOULD HAVE TAKEN FOUR WEEKS OF EMAILING TOOK FOUR HOURS FACE-TO-FACE.

-John and Erin O'Sullivan, Benchmark Clothing founders





John and Erin manufacture standard clothing but with one big difference: their clothes can protect against temperatures four times the surface of the sun. So when their manufacturing plant in India had a problem, it wasn't the type of thing they could fix over email. Thanks to British Airways' Face-to-Face program, they put that fire out before it started.

Last year at British Airways, we put hundreds of small business owners in front of the people they needed to see – for free. This year we're doing it again.

To find out more visit ba.com/facetoface.

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professor at the University of Texas at Austin. "During the Cold War, Presidents talked about the Soviet Union. During the 1980s, when the Japanese economy was surging, they talked about Japan," says Brands. "President Obama talks about China for much the same reasons."
—*Kate Andersen Brower*

The bottom line *As Obama faces off with Republicans looking to shrink the government, he often cites China as a model for U.S. spending policy.*

Nutrition Policy

Duck, Sugar! It's a Food Fight!

▶ Food guidelines out next year could provoke a Tea Party backlash

▶ Palin's Twitter feed: "Nanny state run amok!"

Sarah Palin has found a new way to channel the Tea Party movement's anti-big-government fervor—and tweak First Lady Michelle Obama at the same time. On Nov. 9, she showed up at a Pennsylvania school bearing dozens of cookies, a gesture intended to show her disapproval of a state proposal to limit the sweets served in public schools. "Who should be making the decisions what you eat and school choice and everything else?" Palin asked the students, in a clear swipe at the First Lady's campaign to end childhood obesity. "Should it be government or should it be the parents?"



Food is about to become the next battle ground for, well, a whole menu of Washington favorites. There's big government, big business, and the diets of little children. Palin's school showdown happens to coincide with the recurring battle over the federal government's dietary guidelines, which the Health and Human Services Dept. and the U.S. Agriculture Dept. may release as early as January. The guidelines will form the basis for the next version of the familiar food pyramid, which will influence what's served in school cafeterias, what doctors tell their patients, and the nutritional advice given to recipients of food stamps.

This summer, recommendations by the Dietary Guidelines Advisory Committee, composed largely of academic scientists, set off a round of complaints from the food industry. The Salt Institute, for example, said that proposed advice to consumers to eat less sodium would induce Americans to eat even more food to satisfy their salt cravings. Beverage makers said that a proposed warning to Americans to reduce their consumption of sugary drinks overstated their role in the obesity epidemic.

The federal government has been issuing nutritional advice for more than a century and has been generating controversy almost since then. The guidelines are revised every five years and the last set, issued under President George W. Bush in 2005, ignited many objections from the food industry and others. Marion Nestle, a nutrition professor at New York University, says the result was a pyramid that was so watered down it was "useless." The next iteration looks to be as much of a struggle, says Margo Wootan, nutrition policy director for the Center for Science in the Public Interest. "Businesses depend on selling a lot of unhealthy foods."

Once the guidelines are hammered out and the food pyramid is built—shapes other than the traditional pyramid are being considered, including a plate of food, say two advisers to the guideline-writing effort—Michelle Obama will help promote it. When her "Let's Move!" nutrition campaign was launched nine months ago, the food industry initially cooperated. Beverage companies agreed to display calorie information on the front of products and the largest providers of food to schools pledged to double the amount of fruit and vegetables in their meals within 10 years. But recently the companies have resisted further steps, for example by not reducing the volume of fast-food advertising to kids.

So far, Palin and Obama have not openly clashed, but as the food guideline fight gears up, the political tension is sure to escalate. Obama's nutrition efforts "really irritate small government conservatives," says Ross Baker, a political science professor at Rutgers University. "The Tea Party's message," he says, is "back off, people should be able to make mistakes even if it involves gorging themselves on too many nachos."

Or, as Palin put it in a post to her 300,000 Twitter followers before her school trip: "I'll intro kids 2 beauty of laissez-faire via serving them cookies amidst school cookie ban debate; Nanny state run amok!" Ⓑ
—*Kate Andersen Brower*

The bottom line *Sarah Palin appears to be siding with food companies, and against Michelle Obama, over government nutrition policy.*

The Food Lobby Fights Back

How food and drink companies responded to a federal advisory panel's recommendations on new dietary guidelines:

Salt Institute	American Meat Institute	American Beverage Assn.	The Sugar Assn.	National Confectioners Assn.	International Dairy Foods Assn.
A recommendation to limit sodium to 1,500 mg a day would make Americans eat more "to satisfy their sodium appetite and their hunger for taste satisfaction."	Advising consumers to eat "moderate" amounts of meat and poultry may result in nutritional deficiencies.	Telling Americans to avoid sugar-sweetened beverages "overstates the role" of these drinks "in the rising rates of obesity in America."	Says "no causal link can be established between the intake of sugars and lifestyle diseases, including obesity."	Says federal agencies need "to pursue guidelines that are realistic and accommodate all foods, including occasional treats in moderation."	Agrees low-fat dairy products are healthier but is pushing for "moderate amounts of added sugar" to "help increase the palatability" of dairy foods.

BLOOMBERG (1); GETTY IMAGES (3)

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Top Taiwan Global Brands 2010

2010 was very much a time of "wait and see" for leading Asian and global economies. With the value of the country's top 20 brands expanding by 7.9% during a period of ongoing economic uncertainty, the year was, however, an excellent one for Taiwan's leading brands.

"The fact that Taiwan's heavyweight brands are continuing to perform so strongly in such an uncertain economic climate underlines the importance they place on reducing volatility and maximizing financial stability", says Julian Barrans, MD of Interbrand Singapore the leading marketing consultancy behind the study. "Such encouraging progress clearly indicates that Taiwan's top brands are now becoming real challengers on the world stage".

In collating this, its eighth Taiwanese ranking, Interbrand has again used its proprietary judging system and worked closely with the Taiwan External Trade Development Council and BusinessNext magazine. To qualify for inclusion, brand owners had to be publicly listed and earn at least 33% of their brand revenues outside Taiwan (20% of revenues had to come from the owned brand and within Taiwan, or be owned by a listed Taiwanese company).

Interbrand's judging panel leveraged three criteria in evaluating this year's top 20 brands, they were:
One: Project the percentage each brand would contribute to its company's revenues between now and 2015;
Two: Measures how each brand influences demand at point-of-purchase consumers; and
Three: Comprehensively overview each brand's strength in terms of risks versus earnings forecasts.

After careful evaluation, Interbrand's judges awarded each brand a 'net present value' which they estimated as "coming closest to representing a brand's true economic worth".

So here then are Taiwan's top 20 global brands for 2010! Who are we to contradict Interbrand's Barrans when he argues: "Taiwanese brands' steady strides forward once again underline that fact that brands can only succeed by first understanding customers' changing needs and then fine-tuning their attitudes and media-buys accordingly".

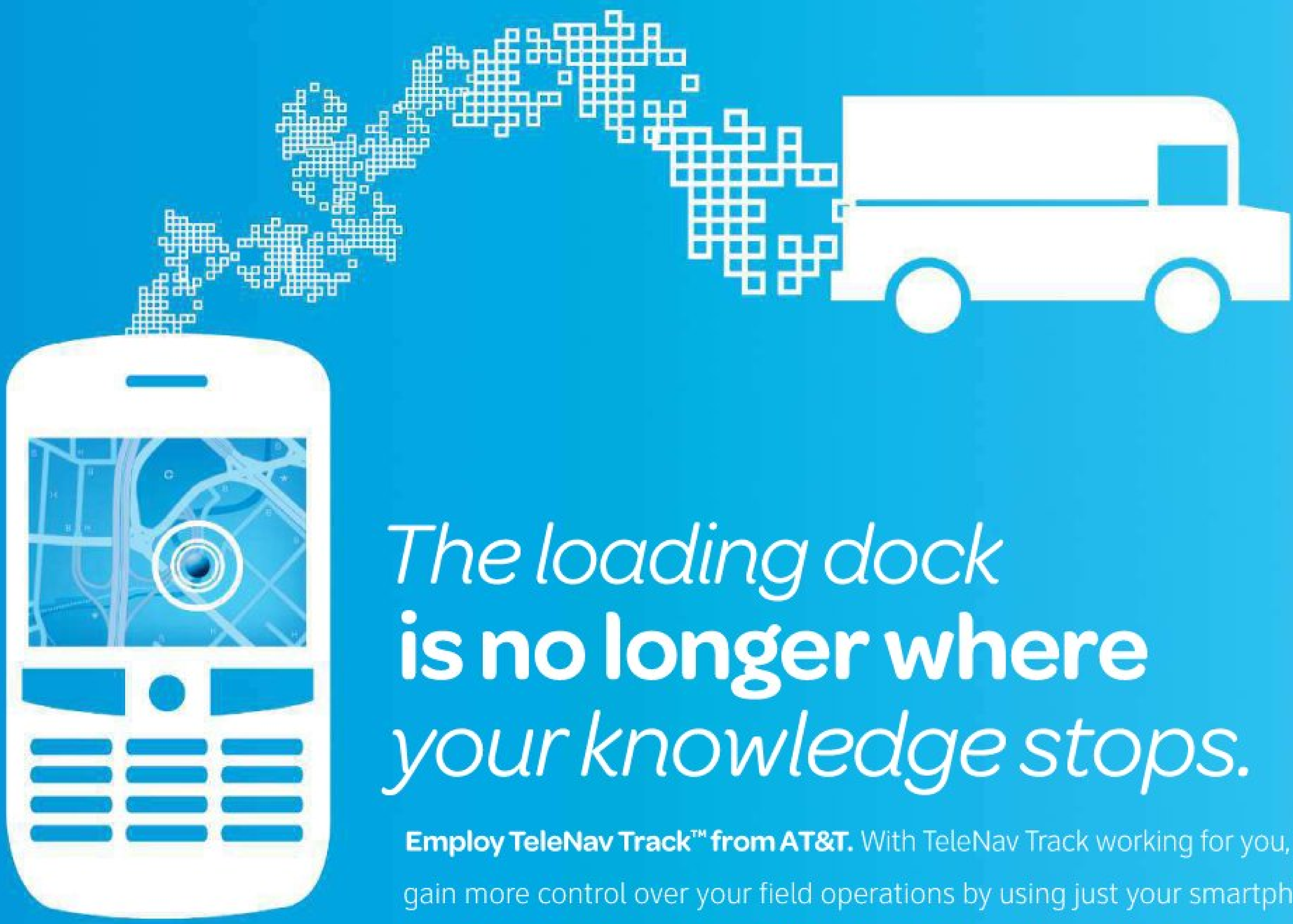
Rank 2010	Company Name and Logo		2010 Brand Value (US$ millions)	Description
	Acer	acer	1,401	Spearheading the global move towards netbook computers, Acer is now world No. 2 in this highly lucrative IT sector.
2	HTC	htc	1,371	Leveraging its "YOU" brand campaign and "quietly brilliant" positioning, HTC remains one of the world's most innovative smartphone providers.
3	ASUS	ASUS	1,285	The leading motherboard manufacturer worldwide, ASUS continues to expand market share and is now also global No. 5 in notebooks.
4	TrendMicro	TREND MICRO	1,228	Following its successful migration of threat protection from desktops to the internet, Trend Micro is now perfecting real-time technological security.
5	MasterKong	康師傅	1,066	Having cemented its position as Mainland China's leading noodlemaker, Master Kong is expanding into higher-end products with more nutritional value.
6	Want-Want		482	2010 saw the world's largest rice cracker manufacturer reinforce its China market dominance with a new non-fried Q rice range.
7	Maxxis	MAXXIS	391	After enhancing its many sports sponsorships with a massive order from Benz Fujie, Maxxis remains China's top tire choice.
8	Giant	GIANT	291	As global bicycle demand rebounds, Giant brands like the specialist Liv women's range are perfectly placed to reap major rewards.
9	Synnex	SYNNEX	276	The words "Chosen by Synnex" remain Mainland IT users' sure sign of integrated value-added solutions that expand with their needs.
10	Transcend	Transcend	240	2010 saw this computer memory leader continue successfully expanding into consumer electronics with award-winning products such as the T.sonic™ brand.
11	Uni-President	Uni-President	197	Audacious initiatives such as sponsoring the New York Yankees saw Uni-President announce its foods' arrival on the world stage.
12	Advantech	ADVANTECH	197	Major developments for this ePlatform pioneer included the acquisition of Germany's D-LoG and entry to the highly lucrative in-vehicle market.
13	D-Link	D-Link	167	2010 saw D-Link's highly flexible XTreme NTM Storage Router honoured with Good Design and several other coveted international design awards.
14	ZyXEL	ZyXEL	159	This highly respected modem maker cum broadband solutions specialist recently received a Carbon Footprint Label from Taiwan's Environmental Protection Administration.
15	Merida	MERIDA	146	Taiwan's second-largest specialist bicycle maker continued to leverage extensive R&D and shrewd sponsorship of the award-winning Multivan Merida team.
16	Johnson	JOHNSON	136	Supplying four best-selling brands to over 60 countries globally, Johnson is now the world's fourth largest specialist fitness company.
17	Gigabyte	GIGABYTE	106	Gigabyte has grown to become the world's second largest motherboard manufacturer and has reached an industry milestone of 1 million SuperSpeed USB(USB3.0) motherboards shipped.
18	CyberLink	CyberLink	104	This year saw Cyberlink further expand its innovative, user-friendly software range with new products such as YouMemo and YouPaint.
19	Genius	Genius	68	Genius' expansion of sales of its computer control devices into major markets' home shopping networks is continuing to pay dividends.
20	Depo	DEPO	50	Maker of Europe's biggest-selling specialist auto lamps, Depo remains a natural first choice supplier for China's vast potential auto market.

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Technology



PHOTOGRAPHS BY ALEX TEHRANI FOR BLOOMBERG BUSINESSWEEK

Inside Zynga's Hit Factory



▶ **The social-game maker is under pressure to make its latest title, CityVille, a smash**

▶ **"I had to run a linear regression on the cuteness of cows and demand"**

On a Friday morning in November, the busiest room at the San Francisco headquarters of **Zynga**, the online game company, is a high-ceilinged loft space behind a door marked CONFIDENTIAL. Bleary-eyed engineers, mostly men in their 20s and 30s, amble about desks cluttered with Red Bull empties, mindful of a countdown scrawled on a whiteboard: 5 DAYS TO LAUNCH. Zynga's latest title, CityVille, is scheduled to begin its rollout at 6 p.m. Pacific on Nov. 17.

Or, rather, was scheduled. The deadline came and went and was pushed back to later in the month. They need to get this one right. Privately held Zynga helped define online social games, the programs played by hundreds of millions of users with their friends on **Facebook** and other social networks. The game maker's 2009 smash hit FarmVille, in which users plant digital crops and use real money to buy farm implements, has held the No. 1 spot among Facebook applications for the past year, with over 50 million users in October. Founded in 2007 by serial entrepreneur Mark Pincus (center photo), Zynga is worth $5.4 billion, according to SharesPost, an exchange for shares of privately held companies. Still, the game industry is "a very hit-driven business," says Edward Woo, research analyst at Wedbush Securities. With social games on track to become a $2.2 billion industry by 2012, according to ThinkEquity analyst Atul Bagga, and contenders like **Walt Disney** and **Electronic Arts** buying their way into the business through acquisitions over the past year, the pressure is on to make CityVille the new addiction for online gamers. No wonder Zynga delayed.



CityVille borrows heavily from SimCity, the classic urban simulation game. Users pave roads and lay railroad tracks to create virtual towns; residents are little computer-controlled characters that walk and drive to and fro. They flourish or languish, depending on

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CityVille borrows heavily from SimCity



how good the player is at urban planning. The game is played within your Facebook page, and once users get a town going they can buy burger joints, coffee shops, and luxury condos, and establish franchise locations in cities built by their Facebook friends. The goal is to increase the population of your town by building more and more sophisticated industries: Small shops become retail empires, villages become metropolises.

With five days left till CityVille's scheduled opening, hundreds of game-building details remain. In the CityVille studio, one staffer works the phones, trying to secure rights to a song for the game's soundtrack. Programmers scan lines of code to figure out why the game still won't load properly on **Microsoft**'s Internet Explorer 8 browser. "We just have to keep nimble," Matt Levine, the game's art director, tells his team during a midmorning huddle. One by one, the designers tick off their to-dos: "3-D batting cages." "Little Italy." "Carousel." "Lighthouse."

Crafting these things can be time-consuming. Yick Kai Chan, a onetime real-world architect who designed banks and stores, spent an entire day perfecting a digital replica of Rome's Colosseum, and another on the Eiffel Tower. The game also needs to be cute. In fact, Zynga's doe-eyed characters and bulbous objects are optimized for adorability, says Chris Han, a CityVille product manager. "Aesthetics is the huge driver for demand for virtual items," says Han. "I had to run a linear regression on the cuteness of cows and demand." (For example, more people buy pink cows than white ones, even if the white ones produce more virtual milk.) CityVille is a warm and fuzzy place: a chubby chef happily ladling soup, a policewoman smiling warmly while dangling a pair of handcuffs. "It's harder than you think to make everyone come across as friendly," says Sean Kelly, CityVille's general manager.

Shortly before noon, Kelly meets with Zynga managers in a conference room papered in Post-it Notes. Good news from the programmers: CityVille's load time—the period between users clicking to open the game and seeing their mini cities on screen—is down by half, to under 10 seconds. (A week later, the time was shaved to 5 seconds.) "Load time, especially first loads, equals players," explains Mark Skaggs, vice-president for product development. "The longer the wait, the more people drop off."

Player retention is paramount for Zynga's games, says Pincus. Frequent visitors to CityVille will be most likely to pay for virtual items like gazebos and tennis courts. In the past, only about 1 percent to 3 percent of a social game's users paid for such goods, estimates ThinkEquity's Bagga. Improving that ratio will require careful targeting, so that players are enticed to spend money with just the right suggestions at just the right times. "With FarmVille it was, 'Get our marketplace up and working, and get content in it,'" says Skaggs. "Now I think of it like a store, a curated experience." Players building suburbs may be able to buy ranch houses, while players working on their downtowns will find virtual museums.

It's these virtual stores that are fueling very real growth. Zynga more than tripled its workforce to 1,300 this year, from 400 at the end of 2009. In September it signed a lease for a new 270,000-square-foot office in San Francisco's Potrero Hill neighborhood—the city's biggest commercial lease in nearly five years. The company adds as many as 1,000 servers per week, and Pincus says technology and infrastructure have become a bigger cost than people.

After the noon conference has broken up, Pincus pulls Kelly aside to rattle off a few more tasks. "Amp up population," he says, meaning the game should focus more on the number of residents in each city. "The best would be if I could visit a city and 'Like' it," referring to a popular button on Facebook. He takes a sip of tea. "What about the ability to fish?"
—*Douglas MacMillan*

The bottom line *Zynga is under pressure to extend its string of hit online social games. Its next title, due later this month: CityVille.*

Quoted

"I am particularly glad to no longer be asked when the Beatles are coming to iTunes."
—Ringo Starr, on the Nov. 16 announcement that the Beatles' albums will for the first time be available through Apple's iTunes Store.



CLOCKWISE FROM TOP RIGHT: LUCAS SCHIFRES/BLOOMBERG; STEVE MARCUS/REUTERS; MATT SAYLES/AP PHOTO

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A China exchange for startups page 57 ▶



Hardware

Investors Fret as Cisco Scales Back Forecasts

▶ Has a push into dozens of new businesses led to a loss of focus?

▶ Despite some successes, "the numbers just don't add up"

Unlike many of his tech peers, **Cisco Systems** Chief Executive Officer John T. Chambers refuses to admit that his 26-year-old company has lost its youthful vigor. While **IBM**, **Hewlett-Packard**, **Microsoft**, and other old-school technology titans stopped making bold long-term growth projections years ago, Chambers has told Wall Street since 2007 that his sales would increase 12 percent to 17 percent annually over the long haul, boosting his forecast from the 10 percent-plus growth he was predicting before then.

The downside to his optimism became clear on Nov. 10 when Cisco announced third-quarter earnings. Though the company turned in impressive results—sales grew 19 percent, to $10.75 billion for the quarter—shares got slaughtered when Chambers offered a growth forecast that fell far short of his typical bullishness. He's predicting less than 5 percent for the current quarter, although he expects a return to 12 percent or higher in coming years. The stock plummeted during after-hours trading and opened 16 percent lower the following morning. "The general consensus right now," says Ticonderoga Securities analyst Brian J. White, is that Cisco "can't hit Chambers' goals."

The revised forecast has raised concerns that Cisco is losing its focus. With its core business—selling routers and other Internet plumbing—expected to expand by about 9 percent a year, Cisco has been pinning its growth hopes on gear that creates new, byte-hogging ways of using the Internet. The company is working on nearly 40 such initiatives, including network-connected billboards, videoconferencing gear for the living room, and servers and routers tailor-made for data centers.

Chambers believes those projects could add up to a vast tech ecosystem. He says equipment for delivering movies and other entertainment via the Internet and collaboration tools such as videoconferencing will eventually be a $38 billion market. Smart energy meters that let utilities and consumers track power consumption minute-by-minute could be a $10 billion business. And equipment for data centers represents a $50 billion opportunity, Chambers has said. Despite the worldwide recession, Cisco has exceeded 12 percent growth in 5 of the 13 quarters since Chambers upped his sales target. That includes 27 percent in each of the previous two quarters this year.

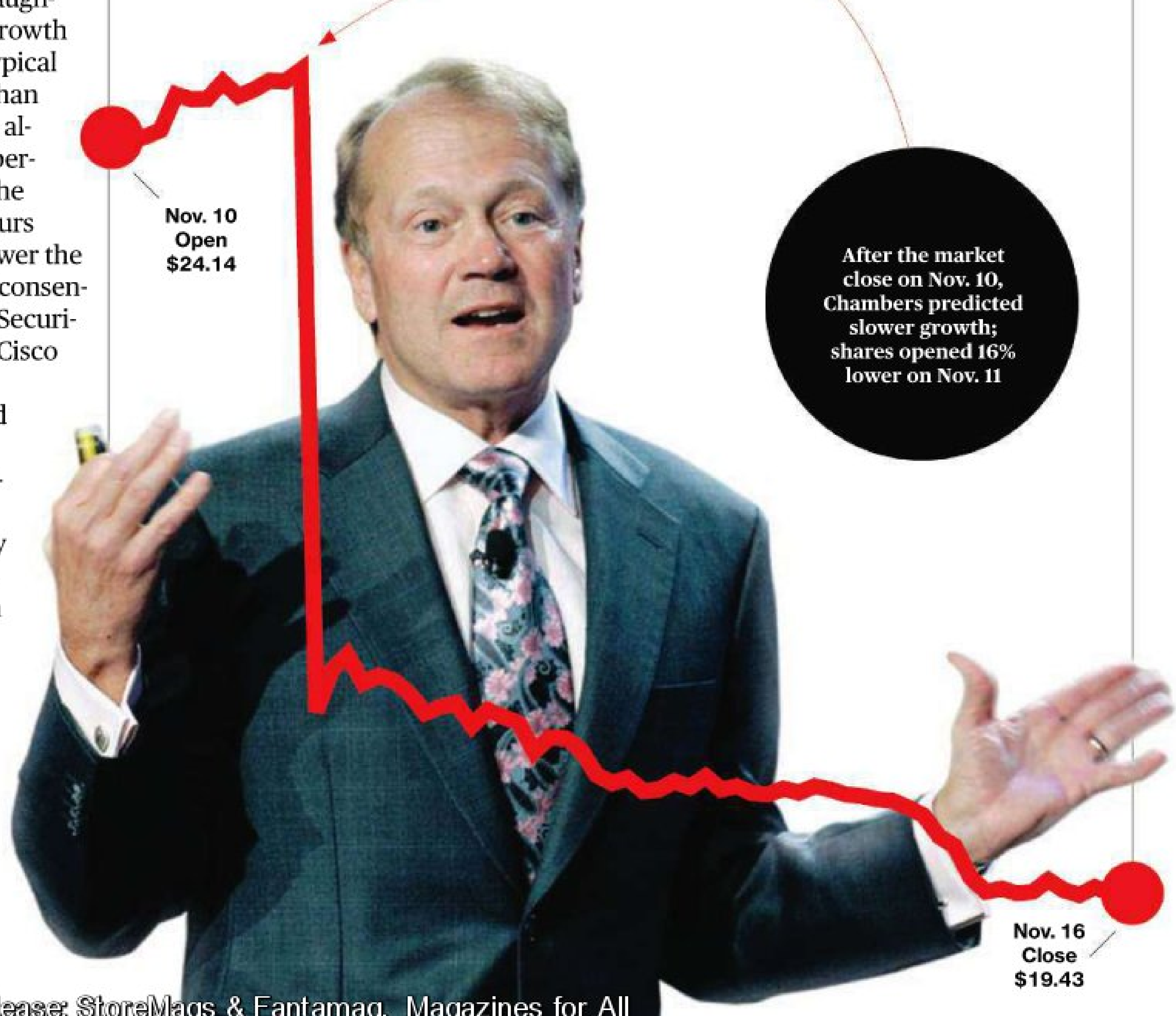
The question is why Cisco now expects harder times even as smaller rivals such as **Juniper Networks** and **Fortinet** say they're powering ahead. Chambers insists the company continues to dominate the router and switch markets, which bring in 60 percent of sales. Other than troubles at subsidiary Scientific Atlanta, which makes set-top boxes for cable and satellite TV providers, Chambers told analysts on a conference call that the biggest problem was a sudden plunge in spending by state governments in the U.S. That's a serious issue for a company that makes 22 percent of its sales to the public sector. Chambers declined to be interviewed for this story.

Some investors fret that the company is lagging in key sectors. Cisco has long been a leader in computer security, a $20 billion market that researcher IDC expects to grow by 9 percent this year. Yet in the most recent quarter, Cisco's security sales fell by 2 percent. Cisco is trailing startups such as **F5 Networks** and **Riverbed Technologies** in some important niches in cloud computing, where processing power moves from a customer's PC to a distant data center. Cisco "is missing out on some things they should be doing," says Jane Snorek, an analyst with First American Funds.

3%–5%

Cisco's growth forecast for this quarter, down from 12% to 17%

Even if Cisco manages to do well in many of the new businesses it's targeting, they may not offer enough scale to achieve the kind of growth Chambers envisions in a company that expects sales of more than $43 billion for ➜



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fiscal 2011. Cisco resuscitated the once sleepy videoconferencing industry in 2006 when it announced its first TelePresence systems. These high-end rigs cost $300,000 per installation but have proven popular because they offer video so real that participants thousands of miles apart almost feel they're in the same room. Since then, Cisco has brought out cheaper systems, and last year it paid $3 billion for market leader Tandberg. Still, Cisco's total videoconferencing revenue will be less than $2 billion this year. "It's not that Cisco doesn't have evidence to show they're succeeding in many markets," says former Cisco executive Jayshree Ullal, who is now CEO of router maker **Arista Networks**. "It's that none of them are large enough. The numbers just don't add up."

One market where the numbers might add up quickly is data centers, though in that area Cisco faces stiff competition. To break into the market, Cisco has developed what it calls the Unified Computing System, a server designed to work with its routers. While that product has been a success—Cisco has signed up more than 2,800 customers that have spent a total of nearly $500 million—it's still a tiny player in the $50 billion server market. And market leaders IBM and HP have started to sell both routers and networking gear, either their own or made by partners other than Cisco.

37

Cisco's acquisitions since 2007

So to meet Chambers' ambitious goals, Cisco may need to keep making acquisitions with its $40 billion in cash. Since 2007, Cisco has bought 37 companies while HP has bought 28, Bloomberg data show. Without all the dealmaking, the company would have grown less than 10 percent in the past two years, figures Erik Suppiger, an analyst at investment bank Signal Hill. "It will be a challenge to achieve 12 to 17 percent growth on a sustained basis," Suppiger says. "I think they need to refocus on their core markets." —*Peter Burrows*

The bottom line *Investors are worried that Cisco may no longer be able to deliver the kind of growth it has in recent years.*

Social Networks

Dear E-Mail: Die Already. Love, Facebook



▶ Facebook's new messaging system is another shot at Google and Yahoo!

▶ "Making communications between close friends the priority"

The annals of obsolete communication technologies are growing all the time. There's the telegraph, the answering machine, the fax, and the paper-based letter, all artifacts from an analog era where messages had resonance hours, even days, after getting them.

Now Mark Zuckerberg wants to add e-mail to that list. In a rollout on Nov. 15 of its revamped messaging system, **Facebook**'s 26-year-old founder declared the age of e-mail over, dragged down by what he called the "weight and friction" of having to remember people's addresses and sort through unwanted messages from strangers. In its place, the social network introduced an inbox that stresses instant communication, mashing together e-mail with instant messages and cell phone texts into a single stream of chatter, customized for the Age of Urgency. "This is a modern messaging system," Zuckerberg declared.

The new service, which will be introduced slowly over the next few months to Facebook's 550 million members, treats every message like a five-alarm fire, popping up on the Facebook screen to be read and answered immediately. Members will get a Facebook.com address and the ability to send and receive e-mail, texts, and IMs from the social network to people who do not use it. And Facebook will record all of it, preserving every missive (even the trivial "hang on, BRB") for posterity. "Five years from now, you are going to have the full rich history of all the communication you have with each of your friends and the people around you," Zuckerberg said.

In the runup to the announcement, industry blogs such as TechCrunch called the impending service a "Gmail killer"—another salvo in Facebook's battle against **Google**, **Microsoft**, and **Yahoo!** for the hearts, minds, and attention spans of Internet users. While Facebook messaging will no doubt change people's communication habits, it's premature to say the service means instant death for Gmail, Yahoo Mail, or any other e-mail as we know it. If anything, Facebook hopes it'll be more of a long, slow asphyxiation. Facebook will probably have trouble getting an older generation of e-mail addicts to give up their accounts. Messages from the site are sent out with a member's profile picture, which could look silly if the subject is business related. The service also uses its members' lists of contacts to organize their communications. Messages from friends, and friends of friends, appear in a user's primary inbox. That sounds sensible, though it can be inconvenient. If Uncle Sherman isn't on Facebook—or your boss, or the bank trying to flag you about a suspicious ATM withdrawal—too bad; their messages get ➔

941

PERCENT

The annual growth in 3G subscribers in China, according to a Nov. 16 presentation by Internet analyst Mary Meeker

DATA: MORGAN STANLEY

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*Based on MY09 Polk statistics as of January 2010 for 10/08–09/09. Honda had the greatest percentage of households return to purchase or lease another Honda vehicle.

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I GOT
FORCED.
THEN I GOT...

Microsoft
Dynamics CRM Online

DON'T GET FORCED.
GET WHAT FITS.

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tossed in with those from various nonfriends in a folder labeled "other."

Zuckerberg and his colleagues concede that it's unlikely people will abandon their other e-mail accounts. They're betting on the next generation—young people already addicted to real-time texts and IMs, who have already largely written off e-mail. "Facebook is making communication between close friends the priority," says Charlene Li, an analyst at the Altimiter Group, a tech consulting firm.

Facebook's rivals are also racing to build simpler, real-time communication systems. Google has long allowed users to see instant messages and texts alongside Gmail, and recently added a feature called Priority Inbox, which tries to gauge a user's most important conversations and bring them to the top of the pile. Former market-share leader **AOL**, now the fifth-largest e-mail provider on the Web, according to ComScore, previewed changes earlier this month that also will integrate texts and IMs, and lets users see images, maps, and other attachments contained in a message in a panel on the side of the screen. Those services are more open than Facebook; for example, their users can link them to corporate mail services like Microsoft Exchange. Facebook isn't there yet.



Zuckerberg, in San Francisco, presenting Facebook's new service

One looming challenge for the social network is spam. Those hundreds of millions of new e-mail addresses, which are based on people's public Facebook IDs, could be easily harvested by spammers. Facebook's system is designed to handle this, since only messages from friends go into the main inbox, and the company has signed a multiyear contract with anti-spam specialist **Cloudmark**, say two people familiar with the arrangement. Still, users can expect plenty of junk in those "other" folders. It would be ironic, of course, if e-mail's oldest scourge ended up adding Facebook's newest feature to the list of endangered communications. —*Brad Stone*

The bottom line *Facebook's hybrid of e-mail, texting, and instant messages is a bet on younger users addicted to real-time communication.*

JUSTIN SULLIVAN/GETTY IMAGES

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Payments

Card Companies Are Wooing Programmers

▶ To compete online and in mobile, they need independent software

▶ **Mobile payments are set to take off**
Total Transaction Value for Mobile Payments



DATA: IE MARKET RESEARCH

Want to skip the line at the ballpark? Download the iConcessionStand smartphone app. It lets sports fans order hot dogs and cold beer from their mobile phones and pay by transferring money from PayPal to a nearby food vendor. An alert pops up when the order's ready.

PayPal, a unit of **eBay**, earns about a three percent cut of the transaction, but the app wasn't built by PayPal's engineers. IConcessionStand is one of more than 1,000 apps devised by entrepreneurs using PayPal X, a software tool that lets programmers work PayPal's payments-processing technology into their own products. These outside developers will generate $1 billion in transaction volume for PayPal this year, the company says.

Now the big credit card networks, looking for ways to increase their presence in mobile and online, are replicating that model. In the past year, **Visa**, **MasterCard**, and **American Express** have spent nearly $3 billion to buy Net-based payment processors. (The most recent acquisition: MasterCard's $526 million purchase of payment company DataCash Group in August.) Like PayPal, card processors are opening their networks to outside programmers. They now understand that "to find the prince you've got to kiss a lot of frogs," says Garry Lyons, the group executive of research and development for MasterCard. "We need to get ideas from as wide an array of sources as possible."

The goal is to ensure that their role in the payments world of the future—whether it be smartphone- or Web-based—is as dominant as it is



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Technology

today. PayPal may process 12 percent to 14 percent of e-commerce payments by next year, according to Mercator Advisory Group. Well-funded new technology startups, including **Zong** and **Obopay**, are trying to make mobile and online payments easier and capture a chunk of the market. Mobile carriers **AT&T**, **Verizon Wireless**, and **T-Mobile** are teaming up to build a mobile-payments company, Isis, and named former **General Electric** executive Michael J. Abbott as its chief executive officer on Nov. 16.

The card networks say their new, open approach will enable consumers to make online payments quickly, without the need to enter a card number and billing address over and over. A shoot-'em-up smartphone game might let players buy add-ons, such as new weapons or extra ammunition, by clicking a Visa logo. A caterer might be able to e-mail a bill with a button that allows a client to pay with one click. Payers will authorize the transactions simply by entering a user name and password.

There's no guarantee software makers will flock to card networks' new tools. Daniel H. Schulman, president of enterprise growth at American Express, says "everyone in the payments industry will begin to realize this is about working closely with the development community." His company plans to open an office in Silicon Valley to meet entrepreneurs and hear developer feedback.

The embrace of third-party engineering is a big change for the payment networks. When entrepreneur and venture capitalist Marc Andreessen developed the world's first mainstream Web browser in 1999, he envisioned integrating credit-card payment functions into his software, but he couldn't get the support of the card networks, he recalled at a conference in California last month. "There was too wide of a culture gap," says Andreessen. Bridging that gap is a first step toward heading off the competition. "The credit-card companies realize they were asleep at the switch when PayPal happened," says Oren Michels, CEO of **Mashery**, which helps companies manage relationships with independent developers. "They vow it won't happen again." Ⓑ —*Joseph Galante and Peter Eichenbaum*

The bottom line *Visa, MasterCard, and AmEx want independent programmers to build payments technologies into new software applications.*

Innovator

Beverly Harrison



PHOTOGRAPH BY JOHN KEATLEY FOR BLOOMBERG BUSINESSWEEK

To bridge the virtual and real worlds, the Intel researcher is designing out-of-sight computers that can recognize everyday objects

Beverly Harrison's kitchen countertop is a lot smarter than yours. Place a steak and a green pepper on it, and the surface lights up with a recipe that integrates both ingredients. Don't like the kitchen's suggestion? Sweep it over the edge of the counter as if the recipe were a pile of potato peelings.

Harrison, a researcher for Intel, designed the setup because she thinks there's a better way to interact with computers than simply "logging into the box," as she characterizes the current state of affairs. The kitchen array consists of a camera suspended above the counter. It sends images to a small, out-of-sight computer that recognizes certain objects and hand gestures. When it spots a food, a palm-sized projector beams useful data–such as cooking instructions–onto the counter. The system is an attempt to design behind-the-scenes computers that bridge "this big disconnect between living in the virtual world and living in the physical world," she says. Harrison's group recently finished a new version of the setup that animates scenes around Lego sets.

Harrison, who holds a PhD in engineering from the University of Toronto and spent 10 years in labs at IBM and other companies before landing at Intel, doesn't expect her employer to enter the kitchen appliance market any time soon. Intel is, however, interested in diversifying away from the PC chip business, which accounts for more than 90 percent of its sales. One way to do that is to more naturally integrate computers into peoples' lives, says Harrison. Her gesture-driven computers may be particularly useful in situations where it's impractical to use a keyboard, mouse, or monitor. For instance, some workers have to wear clean-room suits while handling sensitive, high-tech components such as silicon chips or photovoltaic cells. The bulky protective gear makes it difficult to type or manipulate a mouse. With one of Harrison's set-ups, a worker could instead use simple hand gestures to interact with a computer, or trace numbers and letters on a countertop to input data.

Intuitive human-computer interactions like this may eventually become commonplace, says David Wu, an analyst at GC Research in San Francisco. Work such as Harrison's "will make the computer a much more natural companion for human beings," he says. He notes that new game technology, such as Microsoft's Kinect for Xbox 360, already relies on natural gestures and motion-sensing equipment to power game play.

For all her work dreaming up ways to more closely integrate computers into daily tasks, Harrison leads a largely computer-free existence when she's not at work. "I go home and I have one TV, one stereo," she says. "And I read a lot." —*Ian King*

Career ▶ Spent 10 years working in industrial labs at companies such as IBM

Invention ▶ A setup that recognizes foodstuffs, then suggests recipes

Future ▶ Computers that rely on gestures instead of keyboards and mice

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Markets&Finance



The ChiNext market opening for business on Oct. 30, 2009

AFP/GETTY IMAGES

In China, a Stock Market Where Startups Thrive

▶ **The ChiNext exchange makes it easier for young, fast-growing businesses to raise money**

▶ **"History will view it as a big turning point for the development of the country"**

Han Lingjing remembers pleading for financing from China's state banks. The board secretary of drugmaker **Tianjin Chase Sun Pharmaceutical** says she always heard the same line from loan officers: "You need to have tangible assets as collateral." Translation: no bank money for risky companies. "We felt so helpless," she says.

No longer. Just over a year ago, the ChiNext stock exchange, designed for startup companies, opened for business. Chase Sun was among the first to sell shares to the public, pulling in $113 million when the exchange first opened. Those proceeds allowed it to diversify into new drug lines, lessening its reliance on Xue Bi Jing, its blockbuster drug used to help treat SARS. Third-quarter revenue was up 66.3 percent over the same period last year. "ChiNext gives a pair of wings to a company like ours," says Han, 42. "Now we can fly."

Government regulators created ChiNext, which operates as part of the Shenzhen exchange, to make it easier for companies in what China Securities Regulatory Commission Chairman Shang Fulin has called "strategically important emerging industries" to gain access to China's vast pool of savings. Today, 141 stocks trade on ChiNext, which requires companies to have net assets of 20 million yuan ($3 million), two consecutive years of profit, and cumulative profit of 10 million yuan. The Shanghai exchange requires net assets of 30 million yuan, three straight years of profit, and total earnings of 30 million yuan.

In the 12 months after ChiNext opened, on Oct. 30, 2009, 134 companies raised almost $15 billion through initial public offerings. Over the same time, there were only 24 IPOs on the Shanghai exchange. "History will view it as a big turning point for the development of the country," says

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Markets&Finance

Singapore-based Mark Mobius, who oversees $34 billion for Templeton Asset Management.

Fostering the growth of smaller companies is part of Beijing's effort to reduce the country's reliance on exports of basic manufactured items and encourage the creation of higher-value goods and services. Twenty years after stock trading began in Shanghai, China's markets are booming. Its companies have a combined market value of nearly $4 trillion, second only to U.S. stocks. Yet when it comes to listing, regulators favored big, state-owned companies such as **PetroChina** and **Industrial and Commercial Bank of China** and tended to ignore enterprises bubbling up out of the private sector.

Regulators hope that ChiNext will spur investment from private equity and venture capital firms, because it makes it easier for the companies they back to go public. Already, 59 percent of companies listed on ChiNext as of October were backed by venture capital or private equity firms, according to research firm ChinaVenture. "ChiNext has speeded up everything," says Li Xiaojun, a partner at Beijing-based venture capital firm **IDG Capital Partners**.

One risk for ChiNext is that its explosive takeoff has driven company valuations to 66 times earnings—about three times the average for Chinese stocks. "The market's still young, it's still flawed, and with an excessive speculative frenzy," warns Beijing-based Fred Hu, former Greater China chairman for Goldman Sachs and founder of advisory firm Primavera Capital Group. Also a concern: a flurry of share sales by senior managers of newly public companies as lockup provisions expire. Xu Xiaonian, a professor at the China Europe International Business School in Shanghai, says the market is a "tool for the powerful and the rich to cash in." ChiNext tightened rules governing share sales by top managers on Nov. 4, prohibiting executives from selling their shares for at least 18 months after the company's initial public offering, up from 12 months.

Others point out that China needs the banking sector to be more responsive to emerging businesses. While companies raised $79 billion in stock sales for the 12 months through October, new bank loans over roughly the same period totaled $1.13 trillion, with most going to state-run companies. According to an Oct. 4 report by Euromonitor International, small and medium-size companies get only 16 percent of all bank loans. "China needs to form smaller, private banks" more willing to lend to young companies, says Hong Kong-based Shen Minggao, Citigroup's chief economist for Greater China.

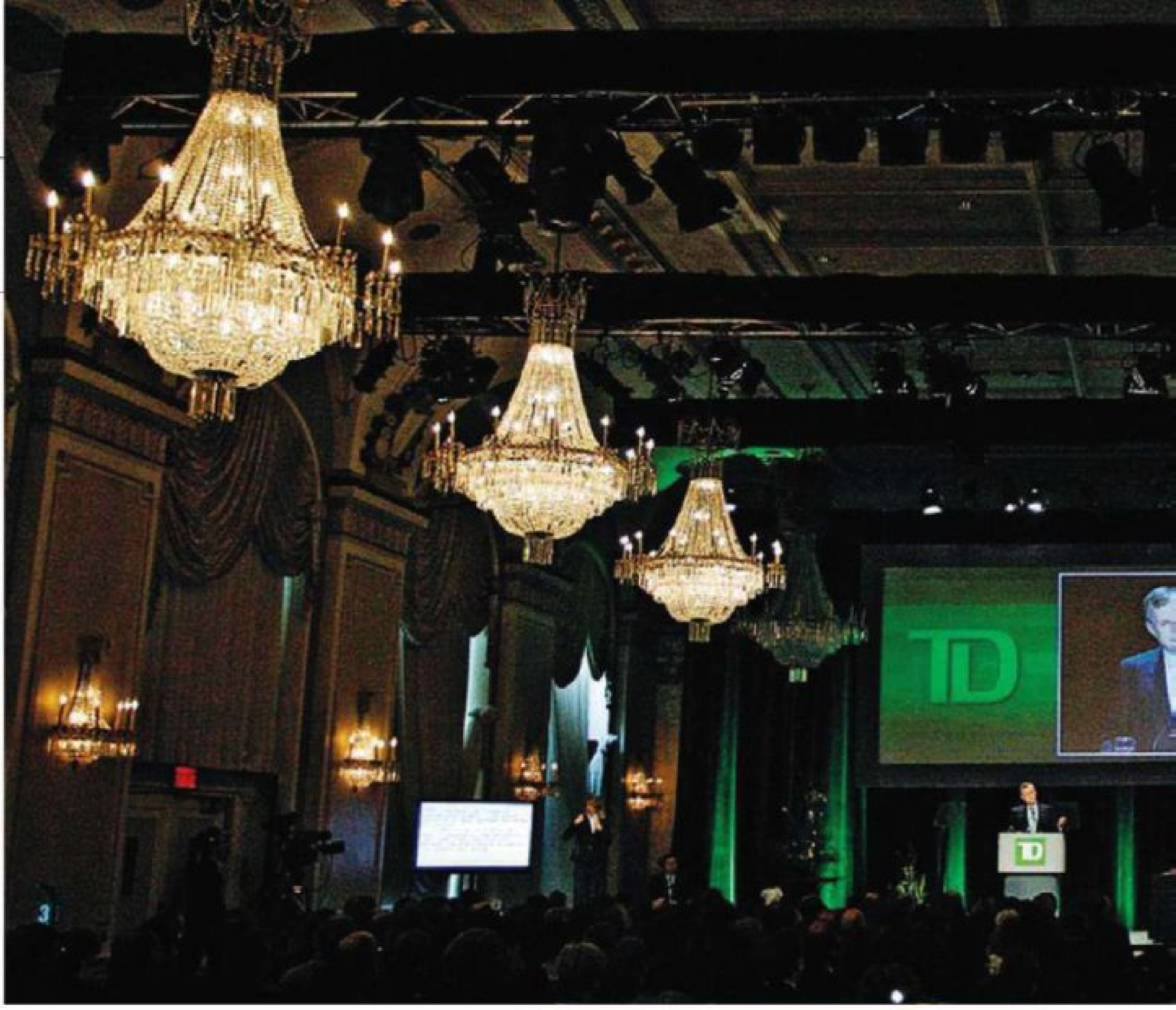
Liu Zehui, executive director of Beijing-based private equity firm Legend Capital, thinks ChiNext is doing exactly what it was meant to do. "The ChiNext market has released the pent-up passion for innovation and entrepreneurship in China," he says. "It tells everyone that you don't have to have a powerful dad to get rich." —*Kevin Hamlin, Eva Woo, and Dexter Roberts, with Frances Liu*

The bottom line *In its first year, the ChiNext market has fulfilled its mission of making it easier for startup companies to raise money.*

Quoted

Even though the economy has been recovering all year, we have seen inflation coming down. ... There is some threat of getting into a Japanese-style malaise."
—James Bullard, St. Louis Federal Reserve Bank president





Banking

From Canada, with Customer Service

▸ Toronto-Dominion uses "retail-tainment" to spur growth in the U.S.

▸ "We made a decision to go big or go home," says CEO Clark

At the main campus of TD University in the Philadelphia suburb of Mount Laurel, N.J., bright green, red, blue, and yellow walls of varying angles brighten dozens of classrooms, complete with mock teller stations and a bank vault. A 400-seat theater hosts everything from pep rallies to air-hockey tournaments. All of **Toronto-Dominion Bank**'s 24,000 U.S. employees must attend a five-hour training session here or at one of 47 other campuses across the country. "You have to buy 100 percent into our culture," says Fred Graziano, president of U.S. consumer banking for the Toronto-based company. "That's how we start them off and let them know what we stand for."

The training is a centerpiece of Chief Executive Officer Edmund Clark's strategy to export the customer service model that has made his bank the most profitable consumer lender in Canada. If he makes it work, he'll do what most Canadian banks have failed to do: post sustained profit in a market more than four times the size of Canada's.

FROM TOP: MATHIEU BELANGER/REUTERS; TOMOHIRO OHSUMI/BLOOMBERG

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Clark speaks at Toronto-Dominion's annual meeting in March

"The next step will be proving the bank can consistently grow revenue in a marketplace in which the competitive, economic, and regulatory backdrop appears much more difficult than what TD faces at home," says Sumit Malhotra, a bank analyst at Macquarie Capital Markets in Toronto.

So far, Clark is succeeding. Canada's second-biggest bank recorded C$282 million ($276 million) in U.S. consumer bank earnings in the most recent quarter—a record for the fledgling division and almost a quarter of the company's overall profit of C$1.18 billion.

$1.6 BILLION

Toronto-Dominion's target for U.S. earnings in three years

Toronto-Dominion said in June that U.S. operations may have earnings of $1.6 billion a year within three years.

Convinced that there were limited growth opportunities in Canada—the federal government blocked domestic bank mergers in 1998—Clark, who became CEO in 2002, set his sights on the U.S. Since 2004, Toronto-Dominion has spent almost C$20 billion on U.S. acquisitions. Its biggest was the March 2008 purchase of Cherry Hill (N.J.)-based **Commerce Bancorp** for about C$8.5 billion. It now has about 1,300 branches in 16 states from Maine to Florida, compared with 1,116 in Canada. "We made a decision to go big or go home," says Clark, 63. "We wanted to make sure that we could ... create a truly North American bank."

Domestic rivals haven't grown as quickly south of the Canadian border. **Royal Bank of Canada**, the country's largest lender, hasn't recorded a profit in the last nine quarters at its international banking unit, which includes operations in North Carolina and Alabama. The lender has spent $4.6 billion buying U.S. consumer banks since 2001. At **Bank of Montreal**, which invested $3.4 billion to build its Chicago-based Harris Bank, U.S. profit accounted for just 6 percent of net income in the latest quarter.

As it does in Canada, Toronto-Dominion counts on customer service to distinguish itself from rivals. It calls its U.S. branches "stores" and pursues a strategy that Bharat Masrani, head of U.S. operations, calls "retail-tainment." Each store features a coin-counting machine —labeled "Penny Arcade"—that's free for customers to convert spare change into bills. People who guess how much change they have within $1.99 are eligible to play a video game where they can win TD-branded prizes.

In addition, many stores feature drive-through teller lanes; free pens; lollipops and piggy banks for children; and water bowls and treats for dogs. Many of the locations are open seven days a week, from 7:30 a.m. to 8 p.m. The bank surveys 800 clients each night to assess the service.

Such touches helped Toronto-Dominion increase consumer lending by 20 percent in the U.S. from the end of 2007 to June 2010, says Masrani. That compares with a 4 percent average decrease among other major U.S. banks, he says.

In addition to boosting lending, Toronto-Dominion wants to increase the number of products it sells to each U.S. client to five or six from three, according to Graziano. "Where we don't have our fair share are things like residential lending," he says. "We have the product set—now we're going back to our customers and we're doing a better job of selling it to them." The bank also plans to have advisers at all branches who can offer TD Ameritrade brokerage products by yearend, Graziano says.

Clark recognizes the timing of his foray into the U.S. wasn't ideal. "Obviously what we didn't anticipate was that the world would have a financial crisis and the U.S. would have the biggest downturn since the Great Depression," he says. Even so, Clark says he is not retreating from his ambitious profit targets for the U.S. business: "Bharat's challenge is going to be, O.K., to the extent that the world's gotten worse, what are you going to do" to reach your goals? —*Sean B. Pasternak*

The bottom line *Toronto-Dominion hopes its emphasis on customer service will help it become the first Canadian bank to excel in the U.S.*

Lending

Citigroup Hopes Small Really Is Beautiful

▶ It wants to loan more to companies with less than $20 million in sales

▶ "There's money to be made for our shareholders"

Citigroup Chief Executive Officer Vikram Pandit, who for the past two years has championed the U.S. bank's "globality," may be getting a new mantra: locality. Citigroup claims 2,500 of the world's 3,000 largest corporations as clients. These days, though, it is keen on targeting U.S. companies with less than $20 million in annual sales and plans to hire about 200 bankers by the end of 2011 to court them. That would bring the

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number of small business bankers to about 500, or one for every two North American branches. "It's a renewed focus for us," says Raj Seshadri, 45, head of small business banking. "We feel we can help business owners and the economic recovery, and there's money to be made for our shareholders." Citigroup employed about 258,000 people as of Sept. 30.



Seshadri: "We feel we can help business owners and the ... recovery"

Expanding the bank's focus to include doctors, restaurants, and cabinet makers alongside Coca-Cola and wealthy individuals won't be easy, says Randy Dennis, president of Little Rock (Ark.)-based DD&F Consulting Group, which advises banks with less than $15 billion of assets on risk management and business strategies. "It's totally different, and it requires a great deal of monitoring," he says.

The four largest U.S. banks by assets–**Bank of America**, **JPMorgan Chase**, Citigroup, and **Wells Fargo**–have been criticized by some entrepreneurs for tightening credit to small businesses after taking a combined $140 billion of federal bailout money. A record 41 percent of small business owners say they can't get adequate financing, an increase from 22 percent two years ago, according to a July report from the National Small Business Assn.

Banks with less than $10 billion in assets make 56 percent of the country's small business loans, according to the Independent Community Bankers of America. Larger banks are now trying to muscle in as losses stay high on home loans and commercial mortgages, and new regulations limit fees and interest rates on credit and debit cards.

Bank of America plans to hire 1,000 employees in the next year to cater to companies with sales of $3 million or less, CEO Brian T. Moynihan said last month. Wells Fargo says it's the nation's biggest lender to small companies. Since last November, JPMorgan Chase has hired more than 500 business bankers.

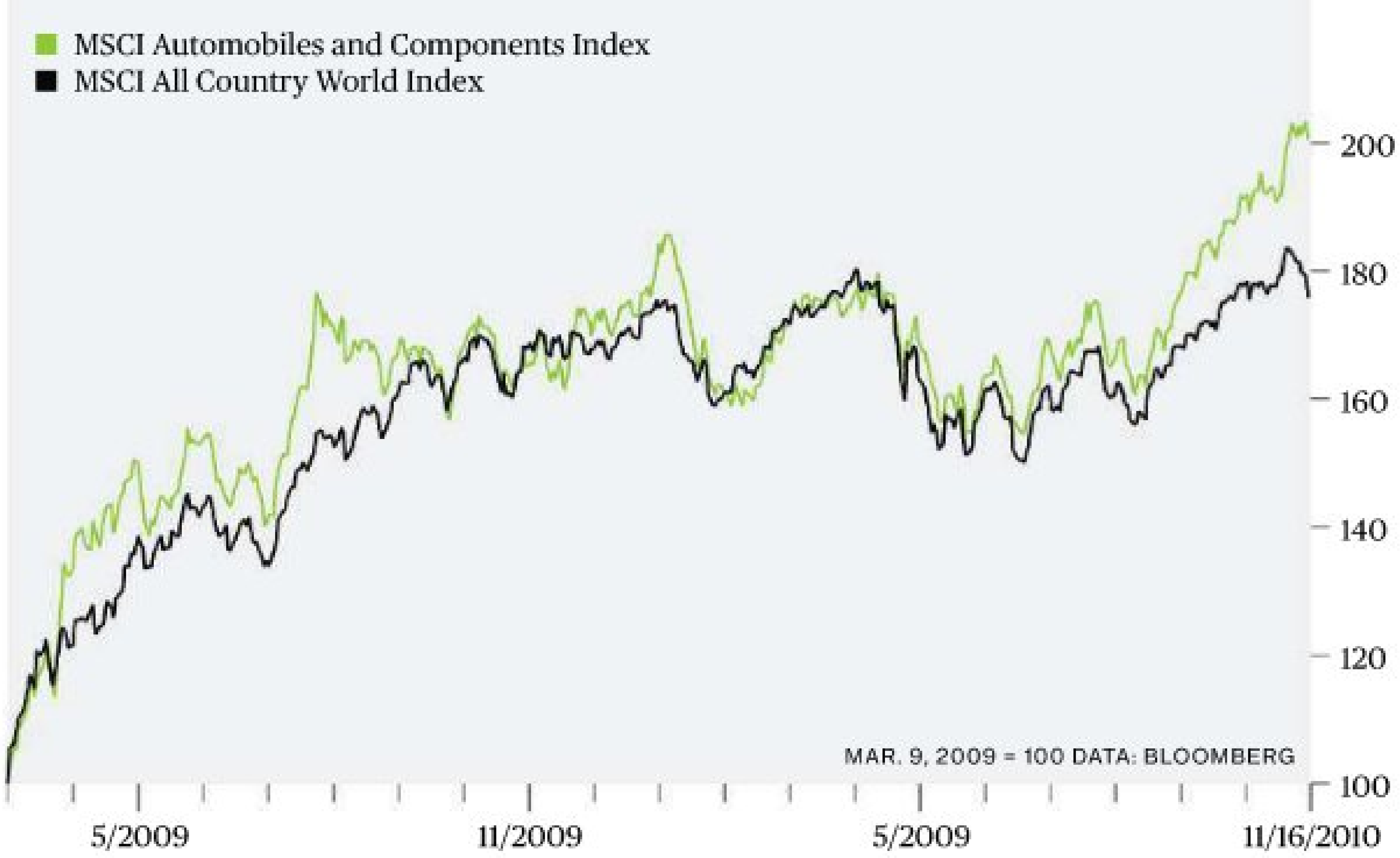
This year through Sept. 30, Citigroup's Citibank unit has made about $4.5 billion of new small business loans in the U.S., about the same amount as it made for all of 2009, Seshadri says. She notes that Citigroup's 1,000 North American branches, concentrated in the northeastern U.S., Florida, Texas, Illinois, and California, are in dense urban areas with the largest number of small businesses. "Geographically they've got it," says DD&F's Dennis. "If they can hire the right people, it could be a home run." —*Bradley Keoun*

The bottom line *Facing losses on mortgages and restrictions on fees, Citigroup is expanding in small business lending.*

IPOs

Investors Are Bidding Up Auto Stocks

Auto stocks rallied worldwide at just the right time for General Motors' initial public offering. Since Sept. 1, an MSCI index of automakers and auto-parts producers has outperformed the MSCI world index. —*David Wilson*



Investment Banking

Jefferies Makes A Move in Mergers

▸ As rivals cut back, it's hiring stars to go after bigger deals

▸ "They are making every effort to play at the upper echelon"

After long arranging mergers and acquisitions for companies that were too small or controversial for the likes of **Goldman Sachs**, **Jefferies** is trying to elbow its way in on the biggest deals.

Hoping to improve on its 23rd-place ranking in mergers and acquisitions, the New York-based investment bank has been on a hiring binge this year, drawing pedigreed dealmakers from **Credit Suisse**, **Citigroup**, **Blackstone**, **Barclays**, and other big firms. Among its recent recruits: Citigroup's Michael Tedesco, who represented Affiliated Computer Services when it was sold to **Xerox** for $7.6 billion in February, a deal bigger than any technology transaction Jefferies has done. It has also signed Barclays' Frank Cicero, a banker to financial companies, and Blackstone's David Bradley, a chemicals specialist.

They're being drawn by the chance to work for a company that's expanding in a downturn–and the prospect of getting 85 percent of their compensation in cash. "Anyone who's followed the market over the last 18 months has seen Jefferies at the forefront of talent acquisition," says Thomas Kade, who runs recruiting firm **TBK Associates**. "They are making every effort to play at the upper echelon of the market."

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Markets&Finance



A $23 million alley for Times Square page 76 ▶

Chief Executive Officer Richard B. Handler, 49, is able to bulk up now because he shunned the kind of big bets on mortgage securities that put **Lehman Brothers** in bankruptcy and cost **Bear Stearns** and **Merrill Lynch** their independence. Bigger investment banks, such as **UBS** and Citigroup, cut staff and bonuses after accepting government rescues and increased the share of compensation paid in stock. Jefferies boosted head count in investment banking 50 percent, to 600, in 2009. Figures for this year are not available. "Many quality professionals who are unsatisfied or disillusioned at the largest commercial banks come to Jefferies because they can accomplish everything their client requires," says Handler.

Until recently, Jefferies called itself a "leading middle-market" investment bank, industry jargon for a house catering to companies with less than $1 billion of revenue. It also took on clients others wouldn't touch, such as Carl Icahn, the billionaire activist investor famed for battling blue-chip corporate boards. Its $4.2 billion market value reflects its position in the Wall Street pecking order: Goldman Sachs has a market value of $89 billion.

The hiring surge began last year when Jefferies lured Benjamin Lorello, 57, and about three dozen of his colleagues from UBS after the Swiss firm slashed its bonus pool 80 percent. Lorello is now head of investment banking and capital markets. Members of his team advised drugmaker **Sepracor** on its $2.5 billion sale to Japan's **Dainippon Sumitomo Pharma** last year, which was bigger than any health-care deal Jefferies had previously completed. Last month they notched Jefferies' first assignment for **Pfizer** on its acquisition of **FoldRx Pharmaceuticals** in October. "Ben is the kind of guy who wants to know why his bankers haven't gone after every deal the competition picked up," says Richard Lipstein, a recruiter at Boyden Global. Lorello would not comment.

It may be a while before the hires pay off. Tedesco, Cicero, and Bradley haven't started work yet, and bankers typically take months before earning fees for their new employer. The average corporate takeover Jefferies advised on in 2010 was worth $505 million, compared with $1.74 billion at Goldman Sachs, according to Bloomberg data. **Morgan Stanley** holds the top ranking in M&A this year, advising on $379 billion in deals, while Jefferies can claim only $37 billion. "It's going to be difficult for anyone" to unseat the top investment banks, says Ada Lee, an analyst at Morgan Joseph in New York, who rates Jefferies shares "sell."

Still, Jefferies earned $260 million in fees this year for advising on mergers and other corporate activities, on track to make 2010 the firm's biggest year on record. Advice on takeovers and restructurings contributes 17 percent of net revenue at Jefferies, which also underwrites and trades securities and manages convertible bond funds. Jefferies shares returned 2.6 percent including dividends over the past three years, beating the two biggest remaining investment banks, Goldman Sachs and Morgan Stanley.

The bank has long been on the lookout for opportunities its rivals ignored. Boyd Jefferies, who founded the firm in 1962, made his name by helping clients trade blocks of shares outside of the stock exchanges. While the practice rankled his more established peers, it eventually became commonplace. (Boyd Jefferies resigned from the firm in 1987 and pleaded guilty to two felonies in connection with the Ivan Boesky insider-trading investigation.)

When junk-bond powerhouse Drexel Burnham Lambert sought bankruptcy protection in 1990, Jefferies hired 60 of its bankers, including future CEO Handler, to expand into high-yield finance. After the tech bubble burst and **FleetBoston Financial** shuttered its tech-focused Robertson Stephens investment bank in 2002, Jefferies scooped up 21 bankers. Now the financial crisis may prove to be its biggest growth opportunity yet.
—*Zachary Mider, with Serena Saitto*

The bottom line *Stepping up where rivals are pulling back, Jefferies is making a bid to get in on the biggest mergers and acquisitions.*

0.6

PERCENT

The 12-month rise in consumer prices, excluding food and energy, through October 2010, the lowest in the history of the index, which dates to 1957.

DATA: LABOR DEPT.

Stocks

Companies Boost Their Profit Promises

▶ Despite the weak economy, executives see fatter bottom lines

▶ **More optimists than pessimists**

Ratio of companies raising estimates to those lowering estimates, yearly peaks



DATA: BLOOMBERG

More U.S. executives than ever are increasing earnings forecasts compared with those lowering them, a bullish sign for stocks. **EBay, United Parcel Service**, and 196 other companies raised profit estimates above analysts' projections last month, while 130 companies cut them, the biggest gap since Bloomberg began tracking the data in 1999. The last time executives were this optimistic, stocks climbed 39 percent over the next 3½ years. "It's important for the rally ... that investors continue to anticipate higher earnings," says Dean Gulis, who manages $3 billion for Loomis Sayles. "That companies themselves are expecting better profits is very positive. As we see rising earnings, we'll see improving stock prices."

About 1.5 U.S. companies boosted earnings estimates above analysts' forecasts for each one that cut projections in October. That's

JUDITH COLLINS/ALAMY

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nearly three times the average of 0.59 in the past 10 years, data tracked by Bloomberg show. The ratio fell to a record low of 0.1 in December 2008. After the ratio reached 1.1 in March 2004, the Standard & Poor's 500-stock index rose from 1,126.21 to a record 1,565.15 in October 2007.

15.4

The price-earnings ratio of S&P 500 companies on Nov. 5

Companies are raising the outlook for U.S. profits at the same time the Federal Reserve is trying to boost the economy by purchasing an additional $600 billion in Treasuries. Retail sales climbed in October by the most in seven months, brightening the outlook for holiday shopping even as unemployment holds near 10 percent. Investors are betting profits at S&P 500 companies with the most business outside the U.S. will beat the market. From July 2 through Nov. 12, corporations getting at least 50 percent of their revenue from foreign sources rose about 11 percentage points more than American-focused stocks.

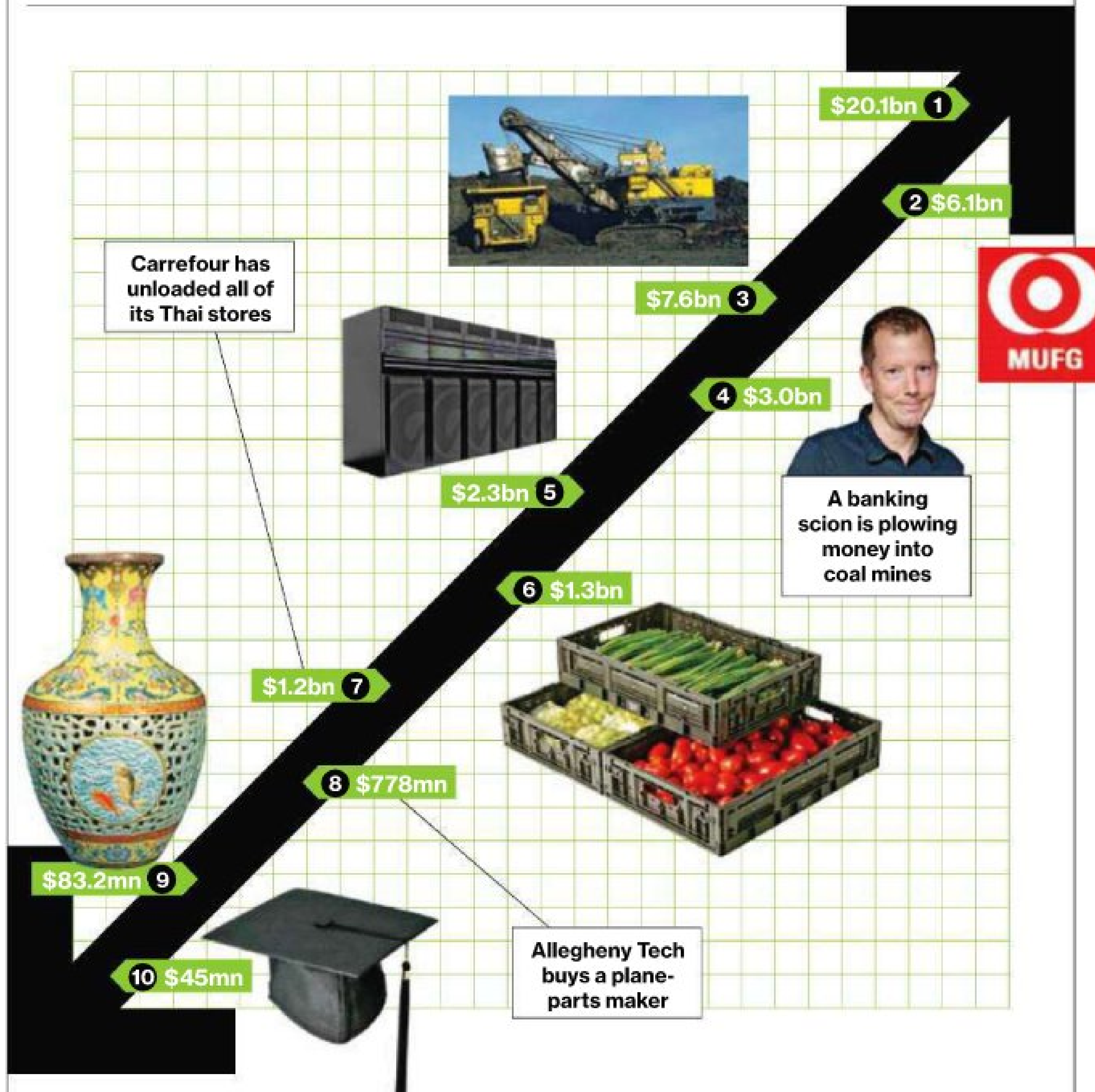
Most companies are earning more than analysts expected. More than 70 percent in the S&P 500 beat profit forecasts in the July-to-September period–the sixth straight quarter that has happened, and the longest streak in Bloomberg data going back to 1993. S&P 500 earnings since Oct. 7 were 6.7 percent higher than analysts predicted, data through Nov. 15 show.

Stock prices may already reflect the outlook for higher corporate earnings. The price-earnings ratio for the companies in the S&P 500 climbed to 15.4 on Nov. 5, based on reported profit from the past year, up from a 14-month low of 13.7 in July, according to data compiled by Bloomberg. "This huge wave of positive guidance has already been priced into the market," says Trym Riksen, chief investment officer for the private banking division of DnB NOR, an Oslo-based firm that oversees about $391 billion. "It would be very surprising if that huge wave were to be prolonged."
—*Lynn Thomasson and Whitney Kisling*

The bottom line *Despite the weak economy, corporate executives see big profit increases coming, a sign that bodes well for the stock market.*

Bid & Ask

by Cristina Lindblad



1 **General Motors** raised at least $20.1 billion selling common and preferred shares in its initial public offering, which enjoyed strong investor demand. Exercising an overallotment option may push the share sale to as much as $23.1 billion.

2 Japan's **Mistubishi UFJ Financial Group** is acquiring a $6.1 billion portfolio of project-finance loans from struggling British lender Royal Bank of Scotland.

3 **Caterpillar** logged its biggest acquisition ever, paying $7.6 billion for Bucyrus, a Wisconsin company that makes mining equipment.

4 **Nathaniel Rothschild**, scion of the European banking dynasty, is investing $3 billion in two Indonesian coal companies through his company Vallar.

5 **EMC** is paying $2.3 billion for Seattle's Isilon Systems to solidify its position in the $19 billion market for external data storage and help fend off rivals such as NetApp and IBM.

6 Australia's **Brambles** bid $1.3 billion for Ifco Systems, a Dutch company that makes plastic produce containers used by Wal-Mart and other large retailers.

7 France's **Casino Guichard-Perrachon** outbid Tesco and other supermarket rivals, paying $1.2 billion for 42 stores in Thailand owned by its French rival, Carrefour.

8 **Allegheny Technologies,** a U.S. specialty metals producer, is acquiring Ladish, a supplier of parts to the aerospace industry, for $778 million.


9 Frenzied bidding among Asian buyers at a London auction pushed up the value of an 18th century **Chinese vase** to $83.2 million, a record for Chinese art.

10 Bennett LeBow, chairman and CEO of bookseller Borders, is donating $45 million to alma mater **Drexel University** in Philadelphia. The gift will help fund construction of a new building for the LeBow College of Business. B

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Singing for Your Colonoscopy

▶ **Artists and musicians trade creative work for medical help**

▶ **Musicians "only consider getting health care when the symptoms are acute"**

Jason Russo, a 37-year-old singer and guitarist from Brooklyn, hasn't had consistent health care since he was a teenager. In October he saw a doctor—though in an unconventional setting: a gig in Kingston, N.Y., 90 miles north of New York City. Russo was one of 70 musicians and artists who bartered their creative services for medical care at an event called the O+ Festival. "It was kind of an amazing thing to sit down with a regular doctor," he says. "Doctors are humans, it turns out. They enjoy rock music and art."

A group of artists and physicians in the Hudson Valley conceived of the gathering. About 40 doctors, dentists, physical therapists, acupuncturists, and others donated 232 hours of service, valued at more than $38,000, to the bands and artists who played or created sculptures or paintings. "It really is about ... helping artists and musicians who are contributing to society find health care at affordable rates," says Arthur Chandler, a doctor at Columbia Memorial Hospital in Hudson, N.Y., and an organizer of O+ (pronounced O-positive).

O+ is part of a growing movement aimed at aiding artists and musicians who can't afford medical care

Chandler and other organizers are incorporating O+ as a nonprofit and want to put on art-for-health-care festivals in Kingston and other cities next year. Like-minded artists, musicians, and physicians from Philadelphia, Minneapolis, Nashville, Berkeley, and Lowell, Mass., have contacted O+ looking to replicate the model. "It seems like something that should be everywhere and could definitely be everywhere," says Julia Henderson, a 32-year-old writer

ILLUSTRATION BY ALEX EBEN MEYER

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Enterprise



O+ organizer Chandler (left) checks out a mural painted for the festival

and development coordinator at a San Francisco theater who hopes to bring O+ to Berkeley. A transplant from Brooklyn, Henderson says she hasn't had insurance for six years.

In recent years, a handful of clinics and hospitals have introduced formal programs for artists to barter for subsidized care. Since 2005, Woodhull Medical Center near the Brooklyn neighborhoods of Williamsburg and Greenpoint–areas flooded with creative types in recent years–has let artists earn $40 in credit toward care for each hour of service they provide the hospital. The work can range from performing for patients, painting murals, or photographing portraits of mothers with their newborns.

Amy Duquette, who coordinates the program at Woodhull, says that 90 percent of the artists don't have any health insurance. "The life of an artist is you're freelancing, your pay is inconsistent," she says. About 600 people have used the program, and some artists have banked enough credits to pay for surgery.

Such programs aside, many self-employed artists like Russo struggle to afford health insurance or treatment when they fall ill. Russo says he lives on less than $25,000 a year from his two bands–a psychedelic rock group called Hopewell and indie-folk combo Common Prayer–and freelance Web marketing work. Once, when he got strep throat, Russo used medicine prescribed for friends' pets because he couldn't afford his own. "The only times when me or my musician friends consider getting health care are when the symptoms are acute," he says.

Artists who performed or created public works of art at O+ were asked to fill out forms describing the medical care they wanted. On the weekend of the festival, as music lovers poured into Kingston bars and restaurants, artists met with doctors and dentists in a makeshift clinic in the ballroom of the 111-year-old Kirkland Hotel. Mike Merenda and Ruthy Ungar, a husband-and-wife folk rock duo, each got dental cleanings and chiropractor visits. Although the couple, both 34, and their two-year-old son have coverage under a state-subsidized program, the plan doesn't cover dental or other wellness visits. While Merenda is grateful for the care, he acknowledges that it's no substitute for real insurance. "It was sort of a one-time fix, and even if they do it once a year, that's not going to solve all your health-care problems as they arise," he says.

Doctors, artists, and their advocates recognize the limits to the approach. "Bartering projects can be a great resource for a lot of people, but it's not a sustainable model," says Judilee Reed, executive director of artists' advocacy group Leveraging Investments in Creativity, which estimates that nearly two in five artists lack adequate insurance. Alexandra Marvar, an O+ organizer who performs with Russo in Common Prayer, agrees that O+ and similar programs can't replace insurance. But she says a series of such festivals around the country could at least offer "a Band-Aid solution to inaccessible health care." —*John Tozzi*

The bottom line *A festival where artists and musicians barter work for medical attention is part of a growing movement.*

Quoted

"For Christ's sake, this is London. This is a capital of international finance. If we can't do better getting money into the businesses of the future, then we're not succeeding."
—British Prime Minister David Cameron, urging lenders and investors to finance small and mid-sized companies



CLOCKWISE FROM TOP LEFT: ALEXANDRA MARVAR; PHOTOGRAPH BY ANTONY CROOK FOR BLOOMBERG BUSINESSWEEK; JOCK FISTICK/BLOOMBERG

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After LeBron, what's left in Cleveland? page 94 ▶



Finance

Boot Camp for Women Angels



▶ A new program trains investors to sniff out smart startups

▶ "Women ... tend to look for women angels, and there aren't that many"

As co-founder of NY Tech Meetup, a group of 15,000-plus techies, investors, and entrepreneurs who gather every month in Manhattan for technology demonstrations, Dawn Barber has plenty of A-list contacts. Yet she hasn't invested in any of the people who've made presentations over the past six years. "I'm poor," says Barber, who supports herself through consulting gigs and other freelance work. "My [husband and I] are just not those people. If we were, I'd try to invest ... in companies led by women."

Barber may soon get her chance. She's applying to the Pipeline Fund Fellowship, a new program for women who want to learn the ins and outs of angel investing (giving cash to a fledgling company in exchange for an equity stake). The fellowship was conceived by Natalia Oberti Noguera (above), a 27-year-old Yale University graduate who this summer launched **Pipeline Fund,** a New York venture capital firm that aims to back so-called socially responsible companies. Her goal with the fellowship is to increase the ranks of female angels and steer more cash toward such businesses.

"There's a lack of gender diversity in the VC investment world," says Oberti Noguera. "And there's a lack of funding for profit-seeking social ventures."

Pipeline's 10 trainees will pay $1,000 each for the six-month program and must each commit $5,000, which will be pooled into a $50,000 investment in a company led by women. Each participant will be paired with an experienced investor such as **Foundry Group** Managing Director Brad Feld or **Omidyar Network** investment manager Dimple Sahni, who will serve as mentors on due diligence, valuation, governance, and other issues. "In a lot of angel networks, not everyone is doing the heavy lifting in terms of deciding where to invest the money," says Oberti Noguera. "In ours, [participants] have to commit to all components, not simply writing a check." She started accepting applicants in mid-November, plans to kick off in January, and will hold a pitch summit in late spring to decide which company to fund.

While women create nearly as many businesses as men, few of them receive angel money. Women account for just 11 percent of the entrepreneurs seeking angel capital in the U.S., and only 14 percent of those got an investment in the first six months of 2010, according to an October report by the Center for Venture Research at the University of New Hampshire. Women entrepreneurs "don't seek capital at a very high rate," says Jeffrey E. Sohl, director of the UNH center. When they do, "they tend to look for women angels, and there aren't that many."

11%

Portion of entrepreneurs seeking angel capital who are women

Longtime angels say programs such as Oberti Noguera's can help change that. "I admire what this young lady is doing," says Vanessa Wilson, a director of Golden Seeds Academy, a similar program run by Golden Seeds, a group of 140 angels that in the last three years has invested more than $4 million annually in companies led by women. Given the relatively small amount of cash the Pipeline group will have to invest, "one of the challenges [they] may face is getting companies to give them enough time to do adequate due diligence."

Oberti Noguera says a partnership with Women 2.0, a networking group of tech entrepreneurs, will help her track down potential deals. She has lined up advisers such as Web pioneer Esther Dyson and has tapped a nonprofit called the Angel Capital Education Foundation for help with the curriculum. And Oberti Noguera is already planning similar programs in San Francisco and Los Angeles for next year.

Her effort is attracting support in the startup community. "Angel investors tend to learn from other angel investors," says Feld. "Anything we can do to encourage more women to be involved and visible is a good thing in terms of the entrepreneurial ecosystem." —*Nick Leiber*

The bottom line *To increase funding options for companies led by women, a new fellowship aims to train more women to become angel investors.*

Economy

Small Biz: Still Waiting For Recovery

▶ Trouble remains even as overseas sales fuel profits for multinationals

▶ Private companies will likely "get revenue later in the business cycle"

The recovery that began in the middle of last year hasn't reached small businesses yet. While corporate profits approach pre-recession levels, income at small private companies is recovering much more slowly, according to data from the Bureau of Economic

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Startups

TechShop's Gadget Factory

Dozens of businesses have gotten their start at TechShop, a Bay Area company that charges inventors and hobbyists $125 a month to use its power tools, metal- and woodworking gear, and design software. TechShop, which has two outlets, plans to expand to nine more U.S. cities in the next year. Here are a few of the ventures hatched in its Menlo Park (Calif.) flagship.



Square

A mobile credit-card reader for the iPad, iPhone, and other smartphones



Fauna Sauna

Infrared heated spa beds for pets intended to relieve pain from arthritis and other ailments



Clustered Systems

Liquid cooling systems designed to more efficiently control temperatures in data centers



Strike Models

Remote-controlled scale models of combat ships used in war games



Embrace

A heated sleeping bag that serves as a low-cost warmer for premature babies in developing countries



Team Phoenicia

Attempting to build a lunar lander and rocket technology for the Google Lunar X Prize competition

Analysis. Proprietors' income—the profits of unincorporated businesses such as partnerships or individuals who work for themselves—is down nearly 5 percent from two years ago, while corporate profits have jumped 21 percent in that period, the BEA reports.

The uneven recovery of small companies stems partly from the diverging fortunes of the U.S. and faster-growing countries. Many big corporations are seeing strong sales from their overseas operations while smaller companies tend to sell primarily to customers in the U.S., says Drew White, chief financial officer at accounting software company **Sageworks**, which collects and analyzes financial data from hundreds of thousands of private companies. "Small businesses are probably going to get revenue later in the business cycle than the big businesses that are exporting to growing markets internationally," White says. "[Large companies] have the ability to shift markets if they see demand."

Sageworks' data show sales down by 5 percent this year at companies with less than $20 million in revenue. Sales were flat or down at such companies in 16 of 19 industries, with only education, health care, and finance showing growth. Construction firms have been hit the hardest: Revenues are down 14 percent for 2010 after a 10 percent drop in 2009. According to surveys from the National Federation of Independent Business, most small companies haven't seen consistent sales growth since 2006, which may contribute to high unemployment given the importance of small business in creating jobs.

Although many small businesses are corporations, the BEA's measure of proprietors' income gauges the performance of the bulk of U.S. enterprises. About 19.9 million partnerships and sole proprietorships with no employees existed in 2008, the latest year for which U.S. Census Bureau data are available. That number fell almost 2 percent from the previous year. While the reason for the slide isn't clear, Small Business Administration economist Brian Headd says the economy may still be too weak to support many small businesses. The drop "was surprising," Headd says. "You kind of expect when the labor market struggles, people are more likely to start their own businesses." —*John Tozzi*

The bottom line *While corporations are bouncing back, sales are still declining at small companies, economists say, which is a drag on hiring.*

Fitness

Time to Think Beyond The Infomercial

▶ After a hit with exercise DVDs, Beachbody aims to widen its appeal

▶ "More people are likely to buy from friends and family members"

Tony Horton has trained senators, soldiers, and celebrities such as Bruce Springsteen and Billy Idol. In the past three weeks, the latter-day Jack LaLanne has been to six states to promote his grueling in-home fitness program, P90X. Soon, Horton is off to Japan and France for training sessions, his first book will be published in December, and he's shopping around a reality TV show. "The first five months of the year I slept in my own bed only 50 times," Horton says. "It's pretty crazy."

P90X, flogged countless times daily on cable TV, is an anomaly in direct marketing. Most of the pills and potions seen on infomercials seem to offer physical perfection with little effort. Horton, by contrast, has persuaded 3 million people to pay $140 for

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his 12-DVD program by promising three months of pain and perspiration in a routine that combines resistance training, yoga, boxing, weight lifting, and a strict diet.

At age 52, 5 feet, 11 inches, and 175 pounds, Horton can do 35 pull-ups, 100 push-ups, and climb a 25-foot rope upside down while barely breaking a sweat. In the videos, Horton combines the discipline of a drill sergeant with a touch of humor left over from a youthful flirtation with stand-up comedy. What Horton calls muscle confusion–a series of varied workouts targeting different muscle groups at different times–seems to work. Initially, "I would do the leg workout and wouldn't be able to walk the next two days," says Liz Beebe, a 29-year-old actress from Los Angeles. "But once you start, you get hooked."

Now that it has built a loyal customer base, **Beachbody**, the Santa Monica (Calif.) company that sells P90X, knows it needs to figure out what's next. It has sold $420 million worth of P90X DVDs since they were introduced in 2005, and buyers of the program will drive nearly half of Beachbody's $430 million in revenue this year. Problem is, P90X sales growth has slowed in recent years, from 85 percent in 2008 to about 30 percent this year. "Fitness is very much like fashion," says Carl Daikeler, chief executive officer of Beachbody. "The important thing is that the company continue to learn from the marketplace."

One thing Beachbody has learned is that P90X isn't for everyone. So the company is introducing programs for the elderly, teens, and the religious (Body Gospel, a program set to church music). Next year, Horton will star in a revision of a less intense P90X variant called Power90, as well as a tougher version for die-hard fitness nuts. And Beachbody has created Spanish-language P90X videos, something it plans to do for its entire product line.

The company is also stepping up a direct-sales initiative called Team Beachbody in which people market products to friends and get a share of the revenues (and a piece of commissions earned by other salespeople they recruit). The plan is paying off: Shakeology, a meal-replacement drink sold only by direct sales, is Beachbody's fastest-growing product.

Daikeler expects Team Beachbody revenue to reach $200 million in 2011, up from $35 million last year. "Long term, more people are likely to buy from friends and family members who got results vs. people who are going to buy from an infomercial," he says. Half of P90X buyers have never even seen a commercial for the DVDs, he says.

Finally, Beachbody is trying to broaden its appeal. The company's website sells P90X drinks, protein supplements, chin-up bars, and other spin-offs. "If you look at direct marketing folks that aren't on television anymore," Horton says, "what they didn't do is work on building their brand." —*Esmé E. Deprez*

The bottom line *After racking up $420 million in sales of P90X DVDs, Beachbody is seeking to reduce its dependence on the smash-hit fitness program.*



Horton promises pain and perspiration—and it sells



Speed Dial Peter Thiel

The PayPal co-founder and Facebook investor explains why he's offering 20 teenage entrepreneurs $100,000 fellowships to leave college

If these people have real business ideas, you could just invest in them. Why the fellowships?
We're not limiting it to people who have ideas for businesses. You don't necessarily have to have a business plan or anything like that. The idea is to target people who'd like to become entrepreneurs and see if there's a way to mentor that process along.

Beyond nurturing young entrepreneurs, what's the broader goal of this project?
We hope this program will stimulate thinking about what education is. People are racking up enormous amounts of debt in school. If you graduate from a four-year college with a quarter million dollars in student loans, that limits your ability to do all sorts of entrepreneurial things. I'm concerned that it's bad for technological innovation, because to start new technology ventures, people need to take risks. They often need to do things where they get paid less than they could earn elsewhere, and with enormous amounts of debt that becomes very hard to do.

So you're saying that education costs too much?
I do think the debt problem is a very big one. The one area where I think there still is a full-fledged bubble is probably education. In one sense it's even crazier than housing, because if you bought a house you couldn't afford, in an extreme case you could always walk away from the house and give it back to the bank. You can't actually walk away from your school loans. You are stuck with them for the rest of your life. —*John Tozzi*

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Enterprise

Entertainment

Bowling for Dollars in Times Square

▶ A tenpin kingpin bets big on a new signature location

▶ Taking "the bowling experience to a whole different level"

In 1997, Tom Shannon dropped $3,000 of his own money and $2 million cobbled together from business loans to buy a 60-year-old Greenwich Village bowling alley. A little more than a decade later, he's standing in what was once *The New York Times* newsroom, contemplating a far bigger bet: a $23 million, 50-lane bowling alley where he hopes corporate partygoers, tourists, and locals will spend loads of time and money.

As he gears up for a mid-November opening, the balding, gregarious Shannon leads a tour of what is still very much a construction site. He points out a sign featuring the alley's new 25-foot-tall neon mascot, "Bowlmor Bob," who will hang above 44th Street swinging a three-foot bowling ball back and forth. Once inside, customers will traverse a staircase built to resemble the Brooklyn Bridge to reach seven distinct areas representing various New York neighborhoods or themes. There's Central Park, with stone arches and trellises; a series of seedy storefronts that evoke the old Times Square; and a handful of black-floored lanes in the "Warhol" zone. There's plenty of detail, from the giant gong for Chinatown to the fake rats in the subway section.

A native of the Washington (D.C.) area, Shannon veered away from a planned career as an academic or diplomat to earn an MBA and nurture his entrepreneurial streak. Arriving in New York in 1993, he muddled through by selling gym memberships and doing odd jobs. "I moved to the city as a single guy with no job," he says. "I didn't really have much downside risk to failure because I was already broke."

In the mid-1990s, Shannon discovered the original **Bowlmor**, a family-owned alley in New York's Greenwich Village. When he got word that the family wanted to sell the unprofitable operation, Shannon pounced. Once in charge, he raised prices on shoes and games and began an overhaul that quadrupled in cost, to $2 million, leaving the company with little working capital. "We renovated during the day, we cleaned up, and we opened for business at 5 o'clock the first 18 months," he says.

The lanes quickly became profitable, drawing locals along with law firms, investment banks, and other companies that used it for parties. Today, half the revenues from the Greenwich Village lanes come from corporate events. Shannon opened five more branches in California and elsewhere, but he always had

PHOTOGRAPH BY MICHAEL KIRBY SMITH FOR BLOOMBERG BUSINESSWEEK



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Bowlmor in Times Square: The new alley has New York-themed areas

his eye on a bigger Manhattan location. In 2008 he sold a minority interest in Bowlmor to private equity firm **Goode Partners** for $15 million. Shannon used the cash in part to fund his long-planned incursion into Times Square, which he expects will push the company's revenues north of $60 million in 2011, from about $40 million this year. The new location "is going to take the bowling experience to a whole different level," says Goode co-founder David Oddi.

Shannon has thrown his share of gutter balls. A business school colleague hired as Bowlmor's first chief financial officer chafed at the startup's restricted resources and left after about six months of what Shannon calls "pervasive friction." And Shannon took on debt for a Bowlmor that was too upscale for its Long Island location, requiring a refinancing that ultimately cost the company about $20 million.

He expects no such mismatch in Times Square. The complex is sort of an Epcot of tenpins whose sections mimic the bustle of New York in a neighborhood that some say shed its own authenticity with its transformation into a mecca for tourists. "Before I embarked on this project, I hated Times Square," he says, recalling the sight of police officers with guns drawn when he first ventured there in the early 1990s. His disdain grew when Times Square went to the opposite extreme, becoming home to the likes of M&M's, Disney, and Olive Garden. He sees Bowlmor as a return to the neighborhood's heyday of vaudeville, cabaret, and burlesque. "We're taking our place," he says, "in the history of that spectacle." —*Lauren Coleman-Lochner and Jason Kelly*

The bottom line *Entrepreneur Tom Shannon is betting a $23 million bowling alley in Times Square will become a hot location for corporate events.*

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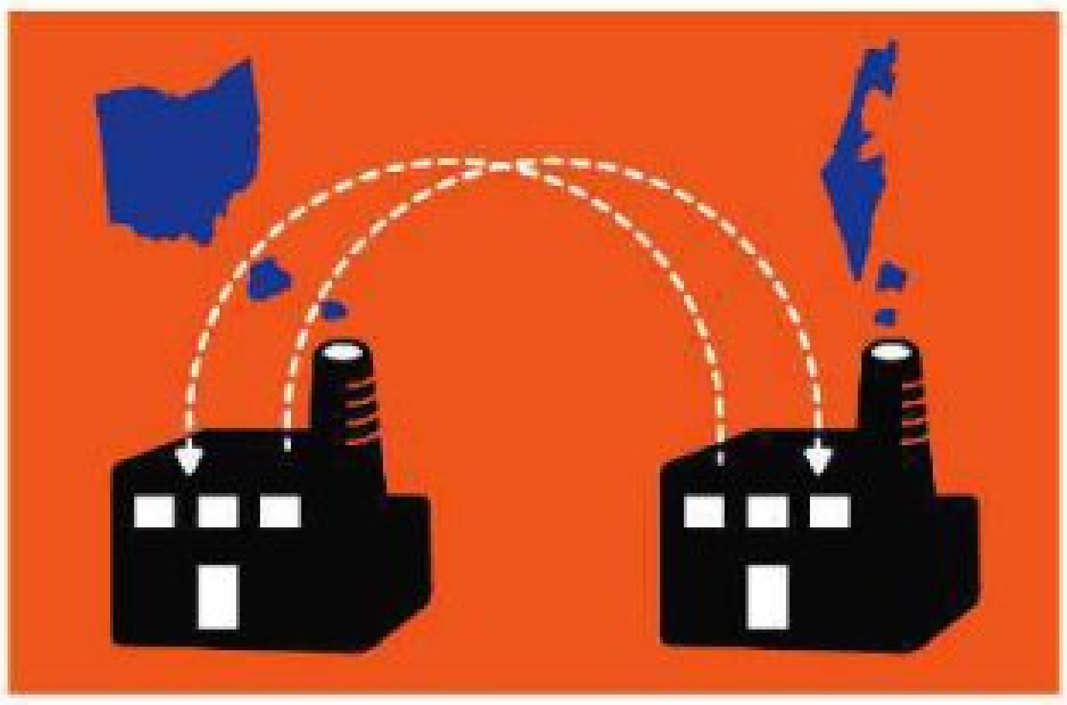
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Biotech

A Bridge from Tel Aviv To Cleveland



▶ Incentives and Ohio investors draw Israeli startups to the state

▶ "Each week I meet two, three companies ... It doesn't stop"

As the Ohio Department of Development's representative in Tel Aviv, Rick Schottentsein is barely able to keep up with his e-mail these days. He's hearing from Israeli biotechnology companies seeking to hook up with Ohio medical experts, clinics, and investors. "Each week I meet two, three companies interested in finding a connection," says Schottenstein. "It just doesn't stop."

Israel and Ohio may seem like an odd pair, but they're helping each other in ways that may link them as business partners for decades to come. Ohio's health-care industry has doubled over the past four decades, to more than 600,000 employees. The state is home to the Cleveland Clinic, a leading research hospital. Israel, meanwhile, has nearly 200 biotech companies, but it's tough for them to raise capital or sell many products in their small home market.

Helped by state incentives and a Cleveland venture capital fund dedicated to investing in Israel, growing numbers of Israeli biotechs are moving to or finding partners in Ohio. In the past eight years at least 14 such companies have raised funds from Ohio-based backers, and a half-dozen of these have opened offices in the state, says Michael Goldberg, founder of the Cleveland-based **Bridge Investment Fund**, which has plowed some $5 million into Israeli biotech startups. Another five or so biotechs based in Israel have plans to open offices in Ohio soon, and dozens more cooperate with Ohio groups in clinical research. "While many Israelis still look to Boston or Silicon Valley for support, Ohio has done more than other states to attract Israeli startups," Goldberg says.

BioEnterprise, founded by Cleveland hospitals and universities to support biosciences in the region, helps connect the Israeli companies with capital, medical expertise, and management teams in the state. The group helped **Simbionix**, a medical device maker that now employs 80 people, transfer its headquarters from Israel to Cleveland. The Global Cardiovascular Innovation Center, a partnership backed by the state of Ohio that funds development of health-related products, has invested in five Israeli biotechs, says GCIC director Thomas Sudow. "Israeli companies provide hospitals here the opportunity to work with leading innovators," Sudow says.

With an office in Tel Aviv, Goldberg's Bridge fund has invested in five Israeli companies. **IceCure Medical**, based just north of Tel Aviv, will soon start U.S. sales of a device for treating benign tumors. And **EarlySense**, which is developing technology that helps nurses track crisis situations, has dispatched researchers to Cleveland. EarlySense Chief Executive Officer Avner Halperin says Bridge has "been instrumental in introducing us to hospitals that are potential partners." —*David Wainer*

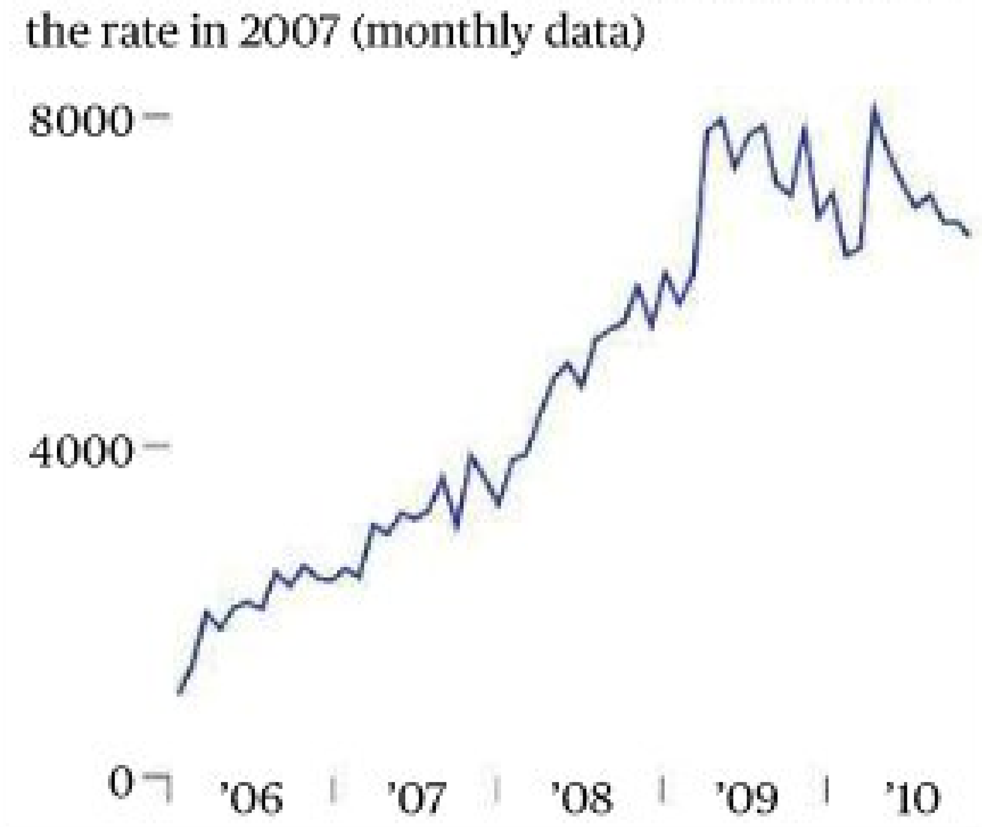
The bottom line *Government incentives and an Ohio venture capital fund focused on Israel have drawn Israeli biotech companies to the state.*

Indicators

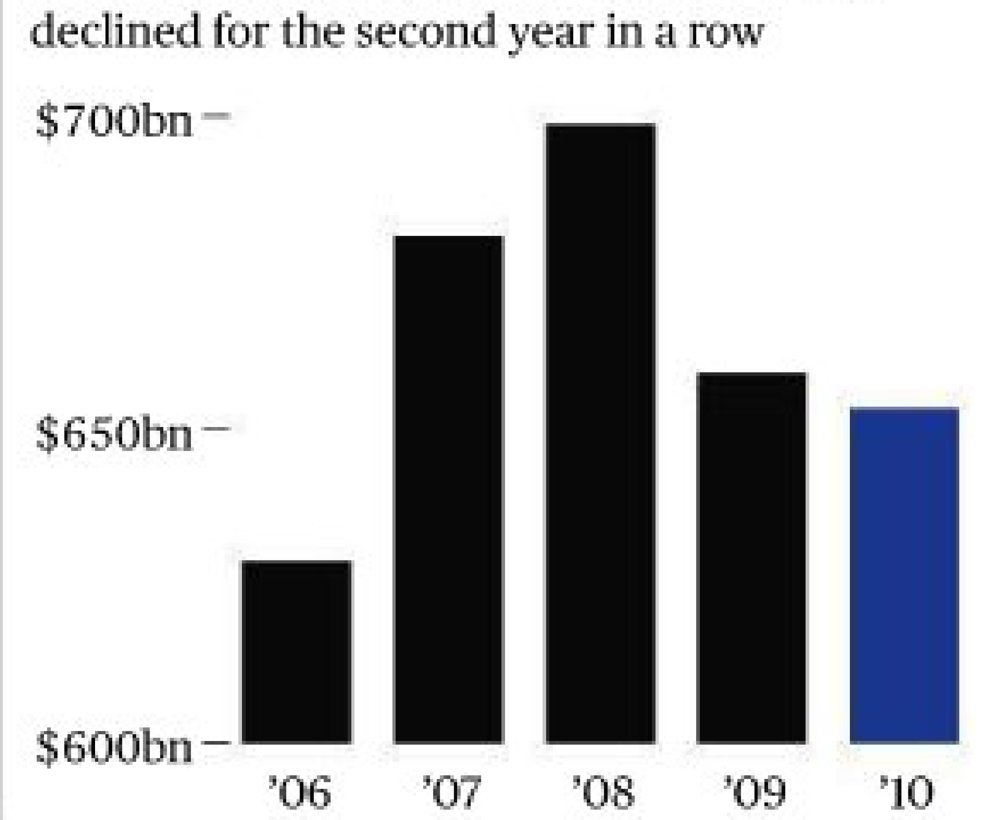
Measuring the Recession's Toll

By many criteria, small businesses are still reeling from the downturn. Bankruptcies remain high, lending continues to fall, and small biz optimism, as measured by the National Federation of Independent Business, stands near historic lows, stuck in recession territory for two years. Here's a look at three indicators. —*John Tozzi*

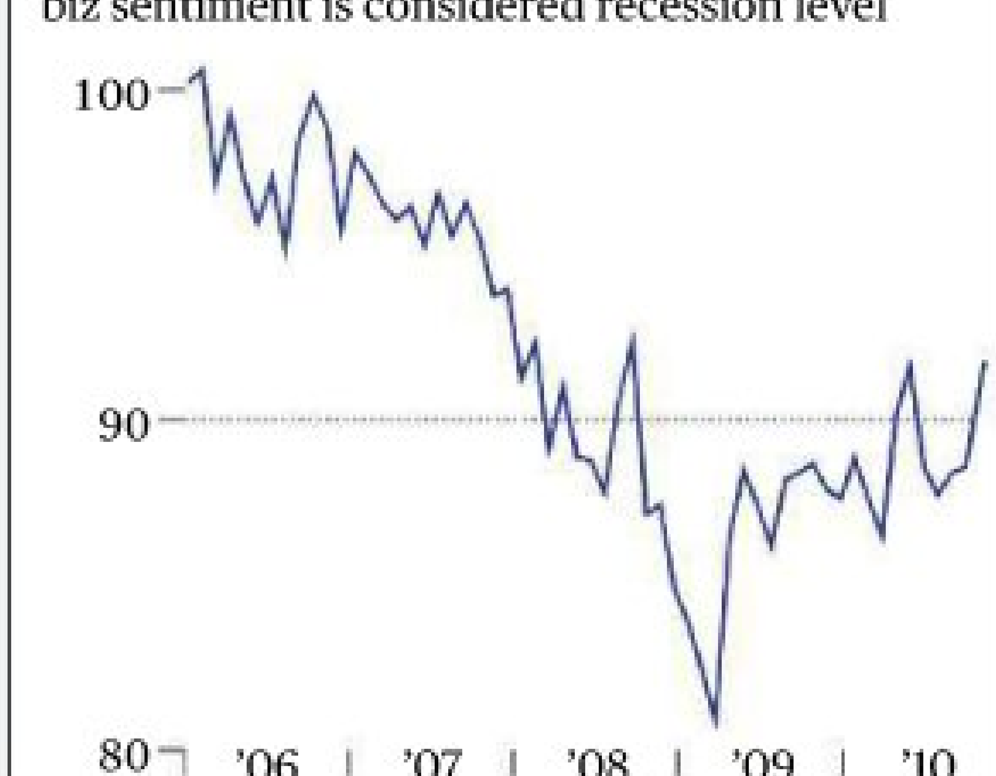
Commercial Bankruptcies
Companies are filing for bankruptcy at double the rate in 2007 (monthly data)



Bank Lending to Small Businesses
Outstanding loans to small companies have declined for the second year in a row



NFIB Optimism Index
Anything below 90 on this measure of small biz sentiment is considered recession level



DATA: AACER, BANK CALL REPORTS/FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

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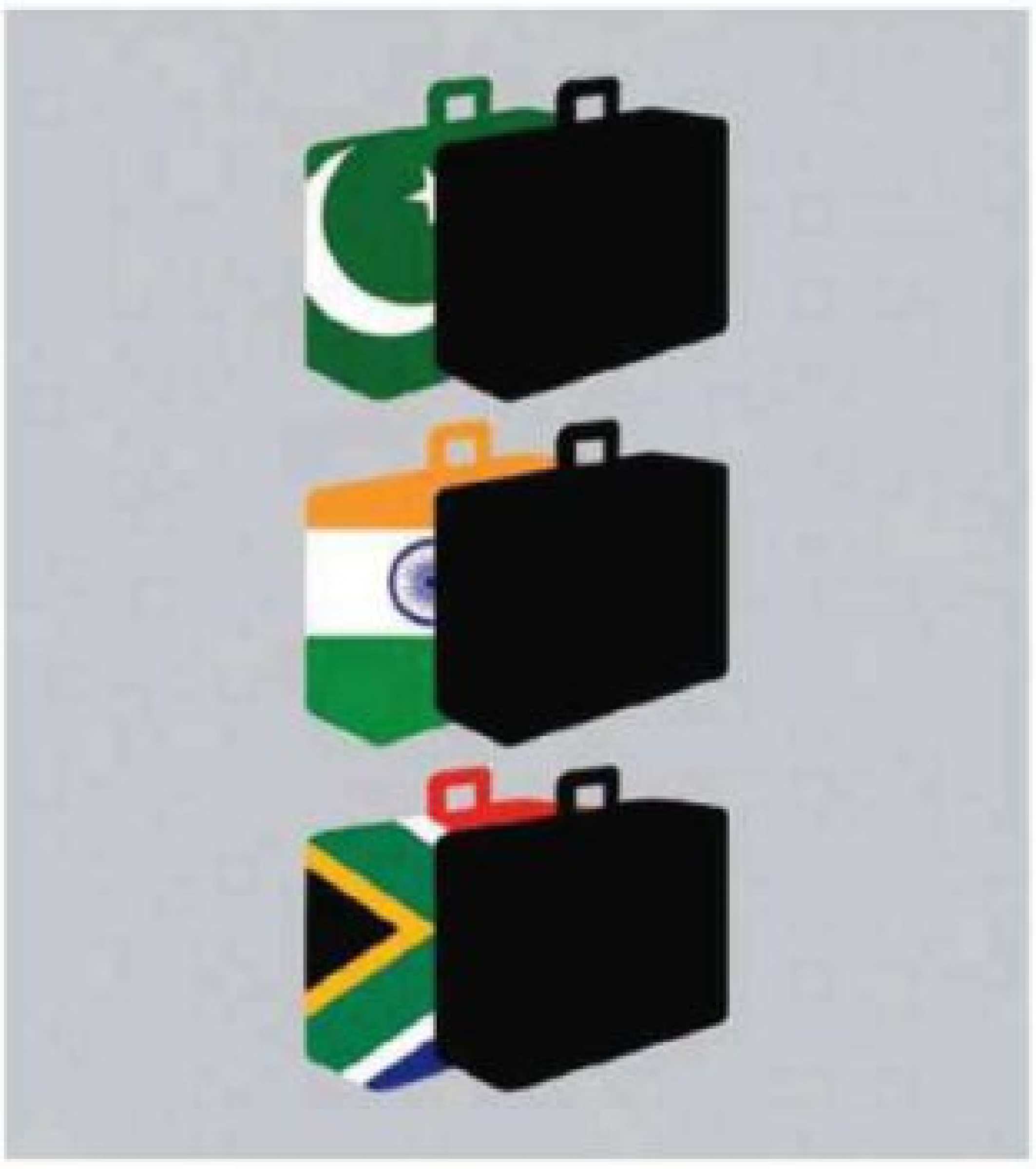
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Deirdre Coyle Jr. and Anne Habiby

Focus On Enterprise

A New Global Growth Engine



Entrepreneurs running sophisticated companies with the potential to create millions of jobs in the developing world are often overlooked by outsiders

Phanindra Sama will tell you the reason he became an entrepreneur is that he missed a bus. In 2005, he was trying to get from Bangalore to his hometown of Nizamabad for Diwali, the annual Hindu festival of lights. But tickets, available only at the bus station, had sold out before he could buy one.

That inspired Sama, then an engineer designing digital chips for Texas Instruments, to create redBus, a website and a network of kiosks, newsstands, and small retailers where customers can see schedules and buy tickets for thousands of bus routes across India. RedBus, which sold 1.8 million tickets in 2009, now has more than 200 employees and is heading toward sales of $30 million this year from commissions and fees paid by bus lines. "The operators had never used any technology of any kind," says Sama, 30. "We demonstrated how [we] could help them grow their business."

Young, dynamic entrepreneurs like Sama are showing up all over the emerging world, building companies that could create new industries—and millions of jobs. But fast-growing developing-world companies like Sama's often stall out because few outsiders know they exist. And their markets offer little in the way of entrepreneurial infrastructure such as venture capital firms eager to invest, small business banking services, and targeted government programs such as loan guarantees. Hoping to identify the most dynamic businesses in the developing world and raise their profile, we teamed up with Harvard management professor Michael E. Porter to found AllWorld Network. We have surveyed 300 fast-growth companies from Africa, the Middle East, and South Asia.

Those companies grew at an average of 40 percent annually over the last three years, and most of them powered through 2009 even as the global economy remained in a funk. In industries ranging from technology to transportation, fashion to finance, media to medicine, they collectively employ over 50,000 people. And they're not just in hot markets such as India and South Africa, but also in Pakistan, Afghanistan, and other troubled countries. While these companies are prospering, to reach the next level they need greater visibility to attract capital, talent, and opportunities. Our research indicates there are at least 2,500 other companies with similar potential to drive economic progress in the next five years.

Our findings challenge popular assumptions that paint entrepreneurs in emerging markets as running tiny operations with few prospects for growth. Though thousands of such companies exist, and governmental and philanthropic efforts are working to help them, we found many genuine growth businesses are often overlooked. Very little outside assistance is available for these companies because many fly below the radar of development agencies and investors.

These companies grew at an average of 40 percent annually over the last three years

When we compared the entrepreneurs leading these ventures with their counterparts in the U.S., we discovered that both groups look very similar. Most have graduate degrees and several years experience working for multinationals, their average age ranges from 30 to 33 when they form their companies, and most are self-financed. Because many emerging market founders have worked for U.S. and European corporations, they know how to shape products and services for different cultures. Such adaptive innovation could create breakthroughs in improving the lives of millions of people—and help spawn companies with immense promise. Developing countries often have underserved niches that can offer rich rewards to those who cater to them.

Just as important, successful entrepreneurs can fuel a nation's aspirations. The companies we have surveyed often serve as a training ground for entrepreneurs, giving employees the skills and financial resources needed to spin off their own companies. And over 70 percent of the CEOs we have interviewed plan to start another company in the next two years.

What holds back entrepreneurs in emerging markets is not a lack of skill or a misunderstanding of business but lack of visibility. If no one apart from their customers know they exist, it will be difficult for them to grow and grab the attention of investors and partners, both at home and abroad, who could help them realize their full potential. By assisting these companies in boosting their profiles we can unleash a new wave of global growth. B

Coyle and Habiby are cofounders of AllWorld Network, which researches and ranks fast-growth companies in emerging markets.

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THE RECKONING

BY SUZY HANSEN
PHOTOGRAPHS BY
ADAM FERGUSON

IRELAND, ONCE THE ECONOMIC SUPERSTAR OF EUROPE, MAY BE GOING THE WAY OF GREECE

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On a Sunday morning in October, Simon Kelly sat in the breakfast room of Dublin's Morrison Hotel, looking eager to chat. Simon, 38, and his father, Paddy Kelly, 66, were once among Ireland's most audacious real estate developers. During the boom years, they borrowed around €700 million from the now-infamous Anglo Irish Bank to buy golf resorts and build hotels. Today, the Kellys are €800 million in debt, Anglo Irish has been nationalized, and the Kellys' former assets litter the streets of Dublin. Discussing the Morrison, Simon says casually, "Oh, I own part of the hotel. Well, not anymore. Now, NAMA owns it."

The National Asset Management Agency, or Ireland's "bad bank," was created by the government in 2009 to help stanch a crisis within the Irish banking system that has pushed the country to the edge of insolvency. Ireland's finance minister appointed NAMA's board–a former bank manager, two accountants, and former government officials–which now controls hundreds of the developers' hotels, offices, and resorts. It remains to be seen whether NAMA will take over the rest of the developers' personal assets. According to spokesman Ray Gordon, "Where NAMA is unable to work with debtors [either by virtue of their refusal to cooperate or the hopelessness of their financial position], then NAMA will pursue all avenues to recover what they can for the taxpayer."

NAMA, excluded from Freedom of Information laws, is famous for its opacity. Its actions, meanwhile, have not stopped the momentum of the crisis. The Irish spent this past week bracing for the arrival of European Union and IMF officials to negotiate a possible emergency bailout of the Irish economy. Ireland has not yet asked for assistance, but in an interconnected euro zone, its neighbors may not allow it the luxury of resisting. "Ireland is our closest neighbor, and it's in Britain's national interest that the Irish economy is successful and we have a stable banking system," says George Osborne, the U.K. Chancellor of the Exchequer. "So Britain stands ready to support Ireland in the steps that it needs to take to bring about that stability."

Irish Finance Minister Brian Lenihan has pledged to work with the EU and IMF while asserting his country's stability. "Our budgetary policy has full confidence among European partners," Lenihan told reporters on Nov. 17. "But in relation to banking, steps taken to date require further support. What may be required may not be in fact an actual transfer of money now but a demonstration of how much money can be made available if further difficulties materialize."

The Irish government underestimated the severity of the crisis for the past two years. As of September, it had injected €45 billion into its banks. NAMA says it will absorb an estimated €73 billion in loans from the banks at a discount of about half of their value. It sounds like relatively small stakes compared with the U.S.'s $700 billion bailout, except that Ireland's population hovers at 4.4 million, according to the World Bank; the bailout so far equals 30 percent of the country's €158 billion gross domestic product. EU officials say Ireland's emergency aid package could be worth $136 billion (€100 billion), roughly the same amount given to Greece last May.

While the U.S. economy was driven off a cliff by the reckless securitizing of subprime mortgages and Greece collapsed under the burden of misrepresented government spending, the Irish traveled a simpler road to ruin: by taking out enormous, unregulated loans. Ireland's economy has contracted for three consecutive years, and the Irish Central Bank governor has declared his country's fiscal deterioration "worse than almost any other country." In mid-November the yield on 10-year Irish bonds almost reached 9 percent, compared with 11 percent for Greece.

There were hardly any critics of the Celtic Tiger from 1995 to 2007, when GDP growth averaged 5 percent to 10 percent and pushed Ireland into the ranks of the world's leading economies. Now seemingly everyone in Ireland recalls a symbolic moment when they realized things had gone too far. For David Byrne, a repossessed-car auctioneer, it was the sight of his fellow countrymen swilling expensive wine. For Simon Ensor, a real estate agent, it was the day the owners of a 1,000-square-foot Dublin carriage house insisted on selling it for €2.5 million, as opposed to the agent's suggested €2 million–and then the house went for €3 million at auction. For many, it was the day the Savoy Hotel in London was bought by Irish property developer Derek Quinlan in a celebrated expression of reverse imperialism.

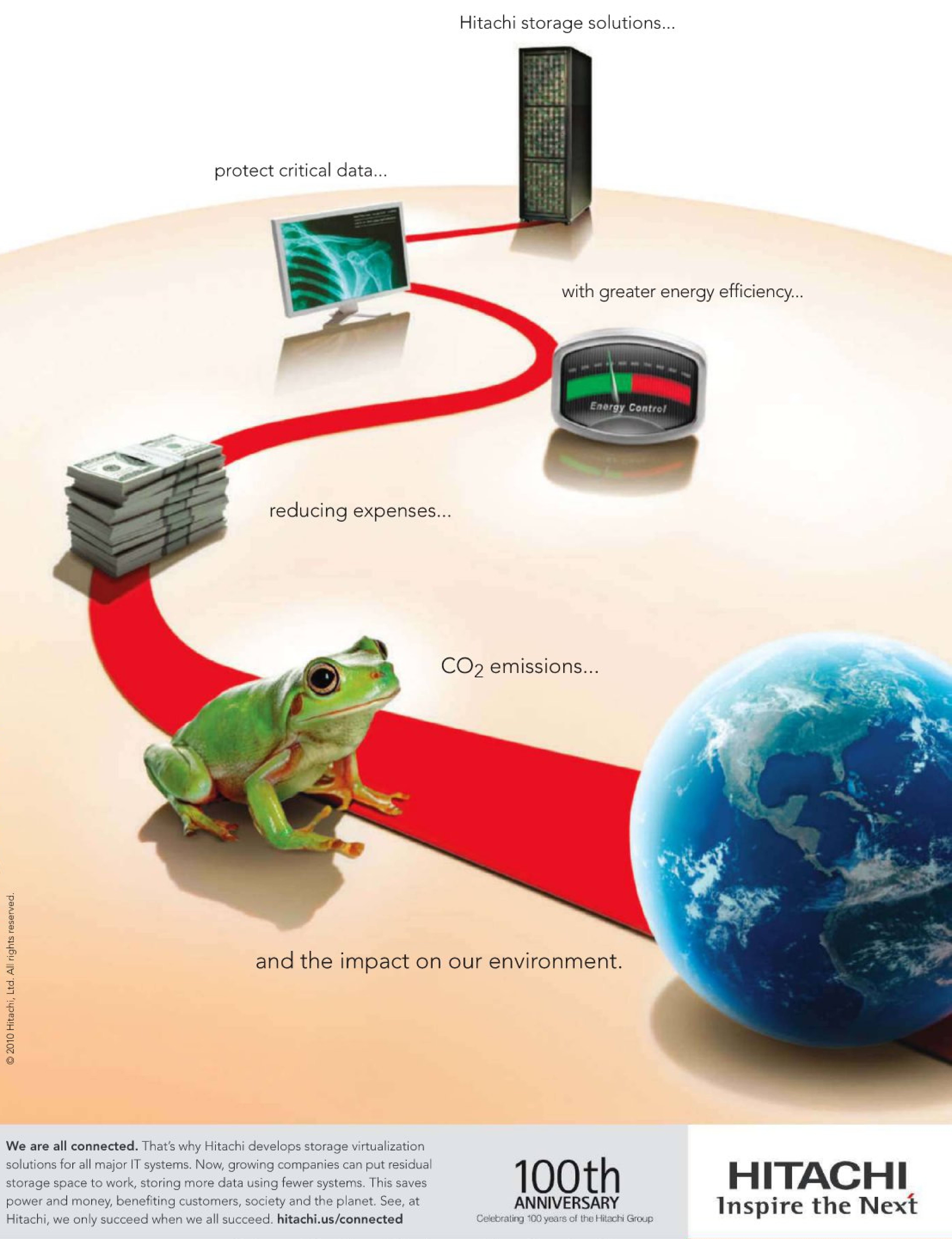
Today, according to former Central Bank of Ireland economist David McWilliams, the average Irish family owes €132,000 to the banks. Ireland's Economic and Social

Father-son developers Simon and Paddy Kelly are €800 million in debt



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Dublin's Shelbourne Hotel, where big deals used to get done

Research Institute estimates that housing prices have fallen 36 percent since their peak in 2006. Unemployment has increased from 4 percent during the boom years to 14 percent. Many Irish people won't be able to pay off their debts in their lifetime, and almost all the commercial developers are broke. The nation once described by *New York Times* columnist Thomas L. Friedman as the second-richest country in Europe has become the country with Europe's largest deficit.

More poignantly, a people who fought against the British Empire for their sovereignty may lose control of their financial future. Brian Lucey, an economist at Trinity College Dublin, says the government miscalculated the crisis' size. "The banks destabilized the sovereign, and the sovereign has destabilized the euro zone," Lucey says. "The banks are totally dependent on the European Central Bank for existence." Of a potential bailout, he adds: "We won't have much of a choice."

Inside an old black Land Rover bursting with pens and wrappers and trash, Simon Kelly conducts a wasteland tour of the Dublin boom years. "We built this thing ourselves," Kelly says as he passes glittering glass buildings. "We were trading with ourselves. And everything was being funded by the Germans through the European Central Bank. So nothing's really changed, if you think about it. We're still being funded by the Germans through the European Central Bank."

Ireland's GDP in 2008

$267 BILLION

According to the Irish Property Council, as many as 29 Irishmen involved in real estate–from property barons to construction workers–have committed suicide since the crash began. The Kellys have steeled themselves against the pain caused by the financial collapse in a uniquely Kelly way: by leaning into it. Paddy was the first of the go-go developers to admit in court, in 2009, that "my liabilities exceed my assets." On Oct. 28, Simon published a book about his misadventures in finance called *Breakfast with Anglo*.

Simon spends much of his time helping NAMA manage his properties, now estimated to be worth €700 million, down from a high of €2.8 billion, and flying to England every four months for a business course on corporate responsibility and sustainability. He hopes someday to create a company that produces something other than glass and steel. "Half of the developers have gone bonkers, half left the country," Kelly says. "Most of the men are 65 years old, so they don't need a new life. I'm 38 years old and have five kids."

"My wife thought we were all nuts," he adds. "She was from a farming family. 'Why do you want all this money?' she would ask."

Two neighborhoods on Kelly's tour best represent the bubble that overwhelmed Ireland. The Docklands, a stretch along both sides of the River Liffey that was once the dodgiest part of town, now has gleaming office buildings, apartment complexes, theaters, and convention centers. It's also where the empty shell of Anglo Irish's new headquarters sits and inoperative cranes loom like morbid giraffes. At night, the lit-up glass offices, the Samuel Beckett Bridge designed by Santiago Calatrava, and the neon rings of Convention Centre Dublin all look like a futuristic project from an architect's computerized modeling system.

Estimated average amount owed by each Irish family to the banks

€132,000

Ballsbridge is the home of Shrewsbury Road, the poshest street in Dublin, where 6,000-square-foot homes once sold for €55 million. The neighborhood also yielded one of the crash's few success stories: the sale of the Jurys hotel in 2005, a bonanza for the property's owner, hotelier John Gallagher. The site consisted of about five acres, and developers were said to be considering bidding €60 million to €70 million an acre, the same price that Chelsea Barracks, the most desirable real estate in London, was going for at the time. Few seemed to notice that while the bidders for Chelsea Barracks included a Qatari real estate investment firm and an American private equity fund, the bidders for Irish properties were almost always Irish.

Driving past Jurys–a five-story brick behemoth rising over lovely, leafy streets–Kelly talks about the bidding war with nostalgia. "It was as if the person who bid the highest was a genius," he says. The Kellys offered €273 million, but Jurys, along with an adjacent site, sold to a developer named Sean Dunne for €380 million. Dunne was celebrated for a time as the "Baron of Ballsbridge" in the press. He's now said to be broke and living in Connecticut. Gallagher, meanwhile, sold much of his hotel chain and escaped the crash with a €1.1 billion profit.


Kelly calls the episode "my awakening moment." "I would look at the Americans, look at Apple and Microsoft, and think they're brilliant, because they produce all this stuff," he says. "And we produce ... we buy buildings. We buy products in Germany and turn them into buildings.

The Irish were long dispossessed of land by an Anglo Protestant ruling class. Simon Kelly's great-great grandfather went to prison in 1882 for promoting land reform during a period known as the Land War. Simon's grandfather was a builder and refurbished elite Georgian houses. For the Kellys, the ultimate goal in life was to become landlords–"You'll never go hungry if you have a piece of land" was common wisdom for a generation. Paddy and his seven brothers did well building houses in the 1960s and '70s. Then he went bust for the first time during the '70s oil crisis, and like many Irish builders, Paddy moved to England during Ireland's miserable recession in the 1980s, where he enjoyed an affluent life in Mayfair. By this time, Simon, the oldest of four children, had demonstrated a

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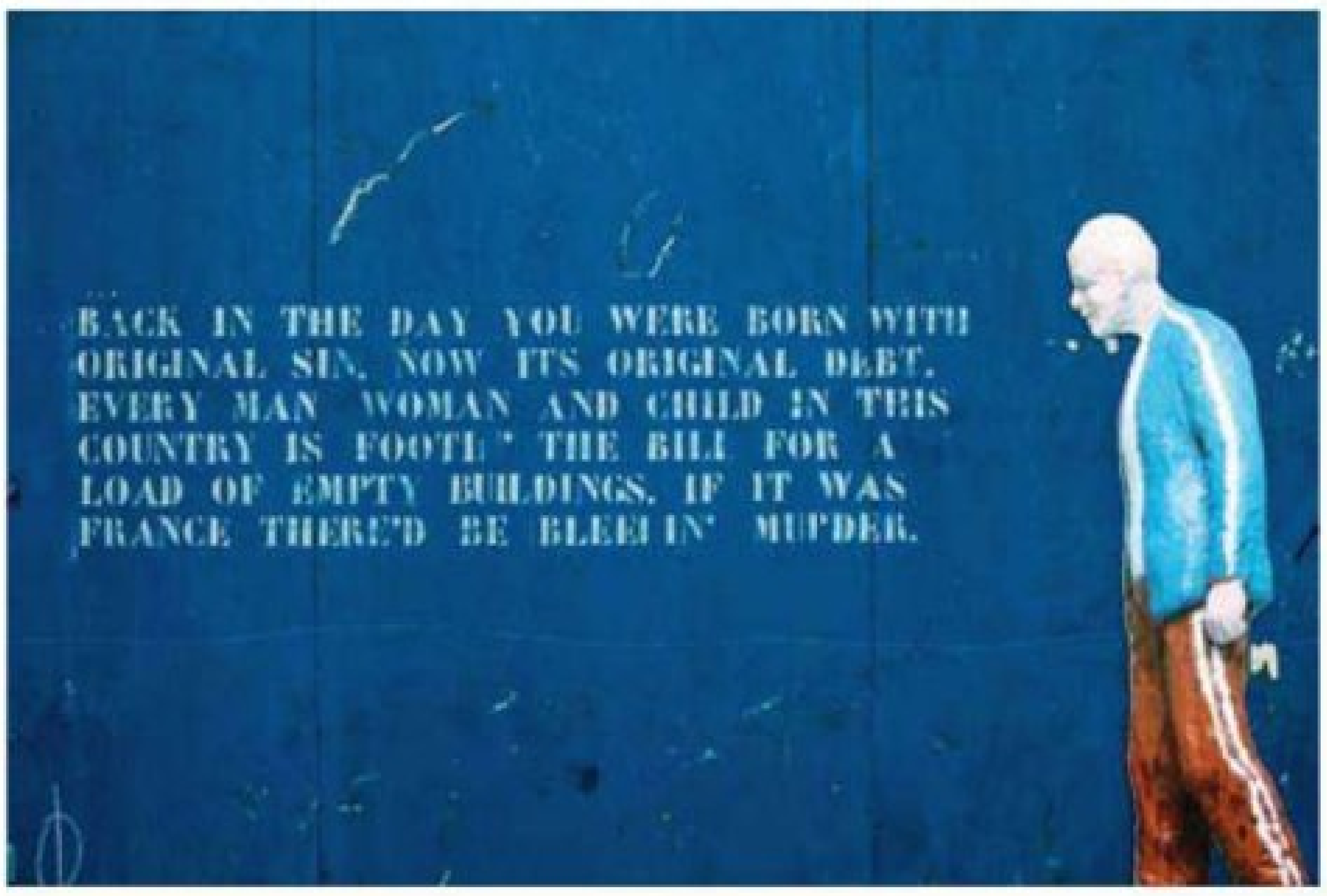
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Above: Graffiti at a construction site in the Docklands. Top right: The would-be headquarters of Anglo Irish Bank. Below right: Some of the 30,000 unfinished homes rotting across Ireland

knack with spreadsheets and gotten involved in the business. When the economy collapsed in the late 1980s, Paddy went broke again and came home.

This time, a new opportunity awaited him. In the late '80s and early '90s, American corporations such as Intel, Microsoft, and Dell arrived in Ireland to take advantage of the country's educated, English-speaking workforce and 12.5 percent corporate tax rate. (Multinationals account for about a fifth of Ireland's GDP.) The foreign companies required buildings and helped start the boom that got the Kellys back on their feet. Simon calls the early '90s their "honest endeavor phase." More and more "builders"—men who didn't go to school, calculated sums on the backs of envelopes, and adopted the American term "developers" only a decade ago—became rich. Soon they would also become national heroes.

The other beast born in the late 1980s was Sean FitzPatrick's Anglo Irish Bank, which, being a smaller bank amid old standbys like Allied Irish Bank and the Bank of Ireland, needed to distinguish itself. FitzPatrick was ambitious, and Anglo began to aggressively offer loans for property development. "We'd have a lovely breakfast at 7 in the morning at the Shelbourne, and I'd say to my lender, 'I need some money,'" Simon recalls, "and he'd give me 10 million quid. Just like that. I could have gamed the whole system if I wanted. There was no amount of money I wouldn't have been lent."

Simon's memoir details endless deals and speculations—acres bought, developed, or flipped. The Kellys couldn't keep track of them all: a ski resort in Italy, a hotel in Malta, the waterfront in Sarasota, Fla. "In the end, I found it vulgar," he says. "It became like Wall Street."

The actual boom ended in 2001, when productivity growth fell to 5 percent. After that the Fianna Fáil government, which has led Ireland throughout boom and bust, failed to spur growth but kept credit flowing easily. "After 2001, we went into this credit-fueled boom," says Brian Lucey. "Although people conflate the booms, one was based on exports and competitiveness, and the other was a decision to keep that going by pouring credit into the markets and not regulating the financial-services industry."

Soon, everyone joined the party. Newspapers published real estate sections 50 pages thick. Developers began to travel by helicopter, the black birds frequently crossing the Dublin sky. Men went to Antwerp for bachelor parties. Ireland's GDP, which had been $25 billion in the 1980s, soared to $267 billion in 2008. The Irish could suddenly boast to the British that "our GDP is bigger than yours." Even more meaningfully, a country that had seen large numbers of its citizens leave for America, Australia, and England now had close to zero unemployment. Even today, the Irish speak of those years with self-deprecating affection. "Getting a mortgage was really like queuing up for cupcakes," says Byrne, the car auctioneer. "Ordinary people were telling their neighbor they're buying a three-bedroom with a private pool in Spain! Ordinary people!"

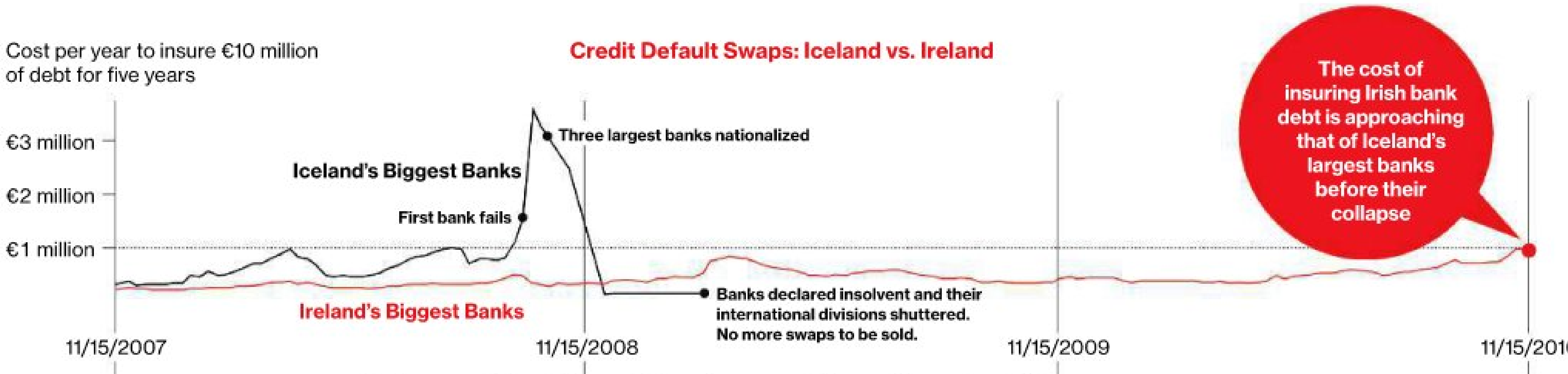
The Irish banks that made all those second houses possible were not investment banks or hedge funds but traditional banks, which found themselves suddenly flooded with cheap credit. "There was a lot of money sloshing around," says Lucey. "Plus, there were historically low interest rates in the euro zone."

FitzPatrick was an early adopter, aggressively loosening loan restrictions at Anglo Irish. Other banks implemented the same strategy to keep up. Financier Niall McFadden told the *Sunday Business Post* that one bank had accepted a personal guarantee for a €6.3 million loan without ever bothering to meet with him.

"They did it because they could, because the regulator was nonexistent and the government was perfectly happy to engage in bubble financing of the public sector," says Lucey. "When the bubbles went away, the whole thing fell apart."

The collapse of Lehman Brothers in 2008 accelerated Ireland's slide, as property prices continued a downward trend that had started in 2007. "As a small, open economy, Ireland was always going to be vulnerable to global swings," says Ray Kinsella, an economist at University College Dublin. "But this is predominantly a self-inflicted crisis."

On Sept. 29, 2008, with the shares of financial institutions plummeting, the government declared it would guarantee the debts of the banks. The financial regulators—who hadn't regulated much of anything for the past decade—didn't realize the extent of those debts, and bankers didn't help illuminate the scale of the crisis. A few days after the guarantee, FitzPatrick appeared on a popular radio program and declared that everything was fine: "The cause of our problems was



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global," he said, "so I can't say sorry with any degree of sincerity and decency, but I do say thank you."

On Oct. 6, something unusual happened to Eugene McErlean: The Central Bank of Ireland's new financial regulator, Matthew Elderfield, apologized to him.

McErlean, 52, had worked for five years as an auditor for Allied Irish Bank. In 2002 he prepared a report for the nation's then financial regulator making a case that his employer had overcharged on hourly rates for the amount of time that bank managers spent with customers. (The range of overcharges tallied some €88 million.) The Central Bank decided against launching an investigation, and a year later McErlean was removed from his job.

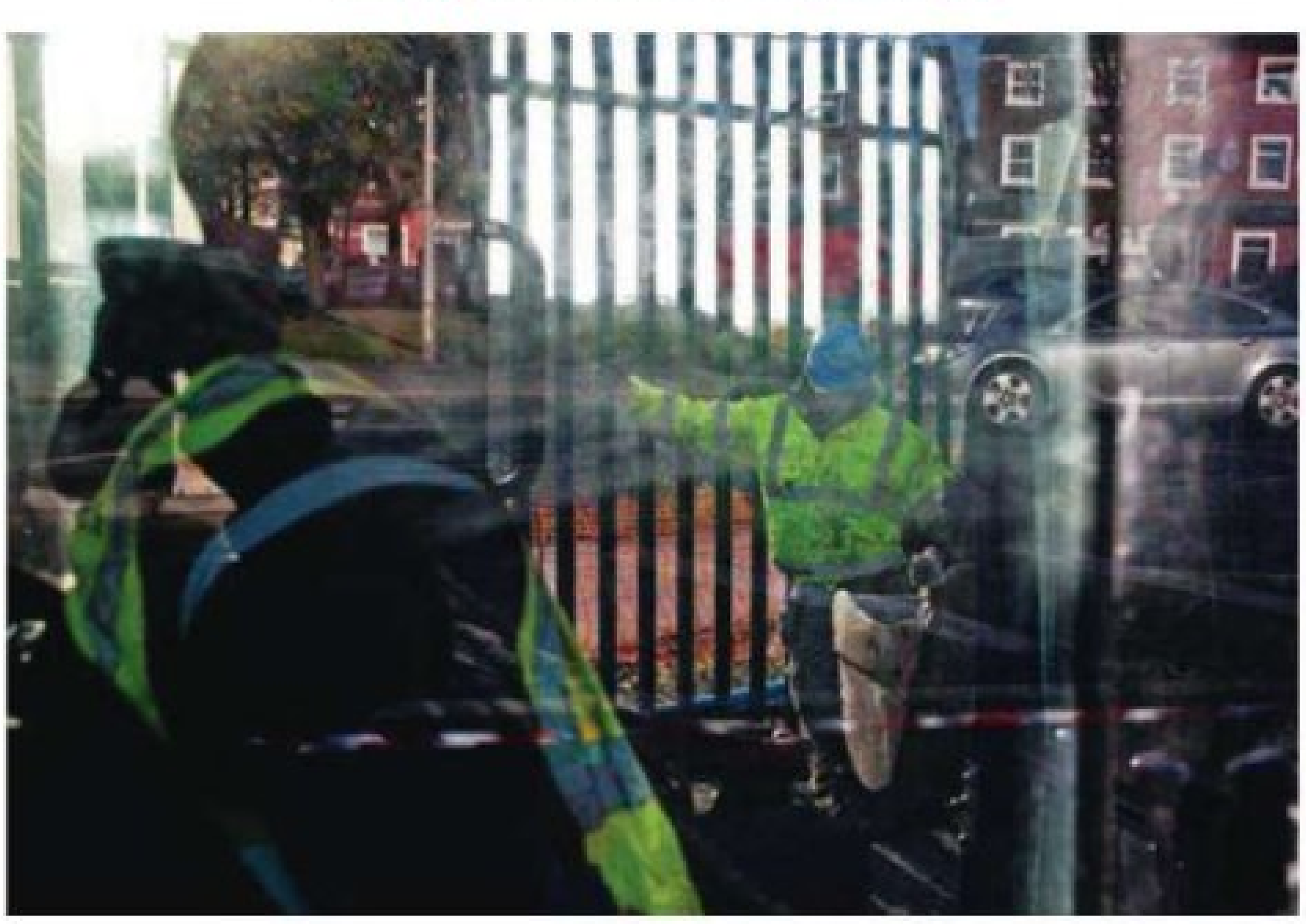
"The banks believed their own publicity, that Irish banks were the best in the world. I had worked other places," he says over coffee in the lounge at Buswells Hotel. "And my job as auditor was to give an independent opinion."

In a rare admission, Elderfield apologized for how his office handled McErlean's case. "Some of the matters could have been handled better by the public authorities involved, and as a result of that I am sorry for any unintentional distress caused to Mr. McErlean," he said before Parliament.

Irish banks operated in a culture of deference and uniformity, and, due to the sharp increase in business and the arrival of a Wall Street culture of performance-based pay, bankers went from making €150,000 a year to millions. As Simon Kelly describes it, bankers also stopped paying attention to their loans. Ireland had 10 to 15 major property developers who could drive the market, and everyone wanted to loan money to them. McErlean says the regulator at the Central Bank, who got reports on this activity at least once a quarter, didn't pay close attention. "If normal checks and balances had been in place," he says, "none of this would have happened."

The Irish still don't really know what went on inside their banks. While at least one banker, FitzPatrick, has been arrested (and released) for fraud, Shane Ross, a senator and author of two best-selling financial books, says criminal activity wasn't the cause of the crash. "It was a simple circle of being interdependent on each other," he says, referring to the politicians, developers, regulators, and bankers. "The country would have gone bankrupt without spectaculars like Sean FitzPatrick."

Developers wanted to turn the Irish Glass Bottle factory site into a mini-Knightsbridge



33%

First-time buyers who bought houses with no money down in 2006

Few whistleblowers or truth-tellers have emerged as heroes in Ireland. David McWilliams and an economist named Morgan Kelly, Ireland's Dr. Doom, were mocked during the bubble years when they predicted a downturn in the country's fortunes. Bertie Ahern, Ireland's Prime Minister from 1997 to 2008, famously dismissed the naysayers at a trade union conference in 2007: "Sitting on the sidelines cribbing and moaning is a lost opportunity. I don't know how people who engage in that don't commit suicide."

Now the very idea of Ireland seems at stake. "This is now about sovereignty," says Diarmaid Ferriter, a historian and author of *The Transformation of Ireland*. "Can we actually survive? Have we lost control? We're very proud of our independence. ... This was a country that fought a Land War and got rid of an English class of landlords, and that was replaced by an Irish class of landowners, speculators, and bankers even more invidious. That's a terrible tragedy."

The grand front entrance of the Four Courts, an 18th century building that houses the High Court of Dublin, was recently reopened to the public. Inside, the mood is grim. On a busy morning in the bankruptcy and home repossessions courts, the judge, Brian McGovern—sad-faced under an obligatory gray, curled wig—sat on a bench in a small wood-paneled courtroom. Six globe lights hung from the ceiling; carafes of water had been placed on the tables and benches. The room soon filled with lawyers in black capes; debtors in jeans hid in the back row.

The bankruptcy session ran long. "I'm sorry," the judge said to the lawyers waiting for the foreclosures portion of the morning. "The bankruptcy list unfortunately has grown in size." There were some 50 cases that day.

Then it was time to deal with home repossessions. In 2007 there were fewer than 10 cases heard in a week; now there are 90. According to the Independent Mortgage Advisers Federation, there are 700,000 active mortgages in Ireland; experts like Morgan Kelly warn that 100,000 of those mortgages are under water, and one in 20 mortgages is at least three months in arrears. In court, most lawyers requested that their clients' cases be deferred for six months, and the judge showed a bias toward granting debtors some breathing room. "There'd be a civil war in Ireland if legislators let financial institutions repossess people's homes," says Byrne, the repossessed-car auctioneer. Because of its history with landownership, when it comes to houses, Ireland maintains a relatively generous forbearance policy, although in 2009, repossession orders were up 27 percent from the year before.

The tradition of leniency made the two couples who stood before Judge McGovern volunteering to relinquish their homes that much more surprising. The judge inquired about their finances, their employment, and their children—and then nearly pleaded with the couple to hold off, to try and get their funds together.

"We're ready to move on," one woman said, her voice breaking. "It's dragging us down."

On Nov. 8, Morgan Kelly published a column in the *Irish Times* on the mortgage crisis. "If one family defaults on its mortgage, they are pariahs: if 200,000 default they

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Jeffrey Hollender, co-founder and former executive chairperson of Seventh Generation, right, speaks with Londel Davis, founder of American Fire Control, in New York, U.S.

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Outside Belmayne Estate, Dublin

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are a powerful political constituency," he wrote. "The gathering mortgage crisis puts Ireland on the cusp of a social conflict on the scale of the Land War."

One of Paddy and Simon Kelly's major projects had been transforming Carton House—a stunning castle-like estate that once belonged to lords of Ireland—into a hotel and residential development. Carton House is now €72 million in debt and partially owned by NAMA, but Paddy enjoys playing its golf course.

It's still unclear whether NAMA will initiate bankruptcy proceedings against developers. For that reason—and because Ireland's bankruptcy laws are devastatingly harsh—many developers have skipped town. Paddy and Simon haven't, though Simon admits to being more nervous these days about the prospect of bankruptcy. In the meantime, they expect to receive civil servant salaries to help NAMA manage their businesses.

Paddy, white-haired and pink-faced, sits in the golf clubhouse dressed in a yellow sweater over a pink button-down shirt. Talking about the Celtic Tiger years, his eyes light up like an aging rock star remembering the '60s. He says they "were magic." Asked if at any point he had become depressed by the crash, he screws up his face and says, "Are you joking?"

"When I was younger, I was the best marble player, and then I hurled them all away," he says. "Someone asked me why. They had no value. The fun was in the game.'"

Paddy quotes sages from Albert Einstein to Elizabeth Gilbert. "The illusion in our lives is attachment," he says, during one of his many philosophical asides. "Yesterday's history, tomorrow's a mystery, but today is a gift, and that's why we call it the present."

Paddy, who last went bust in 1987, knows that tomorrow isn't a total a mystery. "Learn to protect yourself, and have safety nets," he says. "Three years ago I came back from the United States, and I said, 'Everything in America has shut down. When America gets a cold, we get the flu; let's tidy up, see if we're O.K.' " He says he knew what was going to happen 18 months before he went under. "We're comfortable," he says.

Then he tells another story: "When we were building houses with my father and there'd be 20 tons of cement delivered, Daddy'd always take a bag and hide it. When we'd go to finish the job, we'd say, 'Daddy, we run out.' And he'd come with the bag. He taught us all: You have to have savings. You have to have hidden strength and hidden assets. And overall, your first duty is as a family."

Should the developers feel responsible for what happened to their country?

"No question," says Paddy. "But I think the blame game essentially doesn't work. If you take the last few years, we haven't borrowed any money. Why didn't we borrow money? Because it was not available. It starts with the Minister of Finance, but he didn't know what was going on. And the regulator didn't know what was going on. And the European bankers didn't know what was going on. They kept pushing money into Ireland."

Paddy Kelly is already talking about new projects. Simon is less enthusiastic. "I'm an example of corporate excess," he says. When Simon's small son climbs into the car at the end of the Celtic Tiger Graveyard tour, Simon looks at him and says he can't help hoping he finds a future far away from the developers' trade: "I hope he goes to Harvard." Ⓑ

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THE AND DONE

Dan Gilbert watched the world's biggest basketball asset walk away in July—and told him to keep on walking. Now he says his Cleveland Cavaliers are fine without ... you know who. By Ira Boudway

Tens of thousands of feet over Lake Erie in cloudy October skies, Dan Gilbert sits in his eight-seat Hawker 700 jet and celebrates a win. The previous night his Cleveland Cavaliers opened their 2010-11 NBA season with a come-from-behind stunner over the Boston Celtics. "Let me tell you, when we were down 11, that was, that could have gone ... " Gilbert is talking about the third quarter, when the Celtics were pulling away. He can't bring himself to name the damage he imagined unfolding. The Cavs saved Gilbert from having to finish the thought by outscoring the Celtics 38 to 19 in the game's final 16 minutes. Gilbert calls the win the most "emotionally satisfying" of his five years as team owner, a stint that includes eight playoff series victories and a 2007 trip to the National Basketball Assn. finals. He savors this win above all others because it's his first without the man responsible for his greatest loss. His first without ...

Outside basketball arenas, Gilbert, 48, was once known mostly as chief executive officer of Quicken Loans, the largest online retail mortgage lender in the U.S., according to *National Mortgage News*. Gilbert started the company at age 23 with $5,000. He's now chairman of Quicken and its parent, Rock Holdings, a Detroit-based empire of 29 companies ranging from designer sneakers to software to private equity. Yet Gilbert is more recognized these days as the emotionally unbound owner at the center of pro basketball's best soap opera. From 1998 to 2003, the Cavaliers lost two-thirds of their games and, according to 2007's *The Franchise* by Terry Pluto and Brian Windhorst, about $10 million a year. Then, in the summer of 2003, Cleveland newspaper writers won first pick in the NBA's annual draft lottery and chose an Akron teen just out of high school who also happened to be the greatest basketball talent of his generation.

Cleveland is not a city with a history of catching breaks. Its industrial decline has been well chronicled, but its sports teams are, in their way, more tragic. The city hasn't won a major championship since 1964. Yet the local kid was even better than advertised—graceful and dominant on the court and an Ohio patriot off it, infusing the area with pride and packing the Cavs' arena. The mania gave then-owner Gordon Gund, who bought the team in 1983 for $20 million, the chance to cash out. Gilbert, who lost a 2004 bid for baseball's Milwaukee Brewers, put together a small group of investors and bought the team for $375 million. Cleveland made the playoffs in each of Gilbert's first five seasons and became the third-largest franchise by revenue in the NBA—a league that has two teams in the New York area, two in Los Angeles, and one in Chicago.

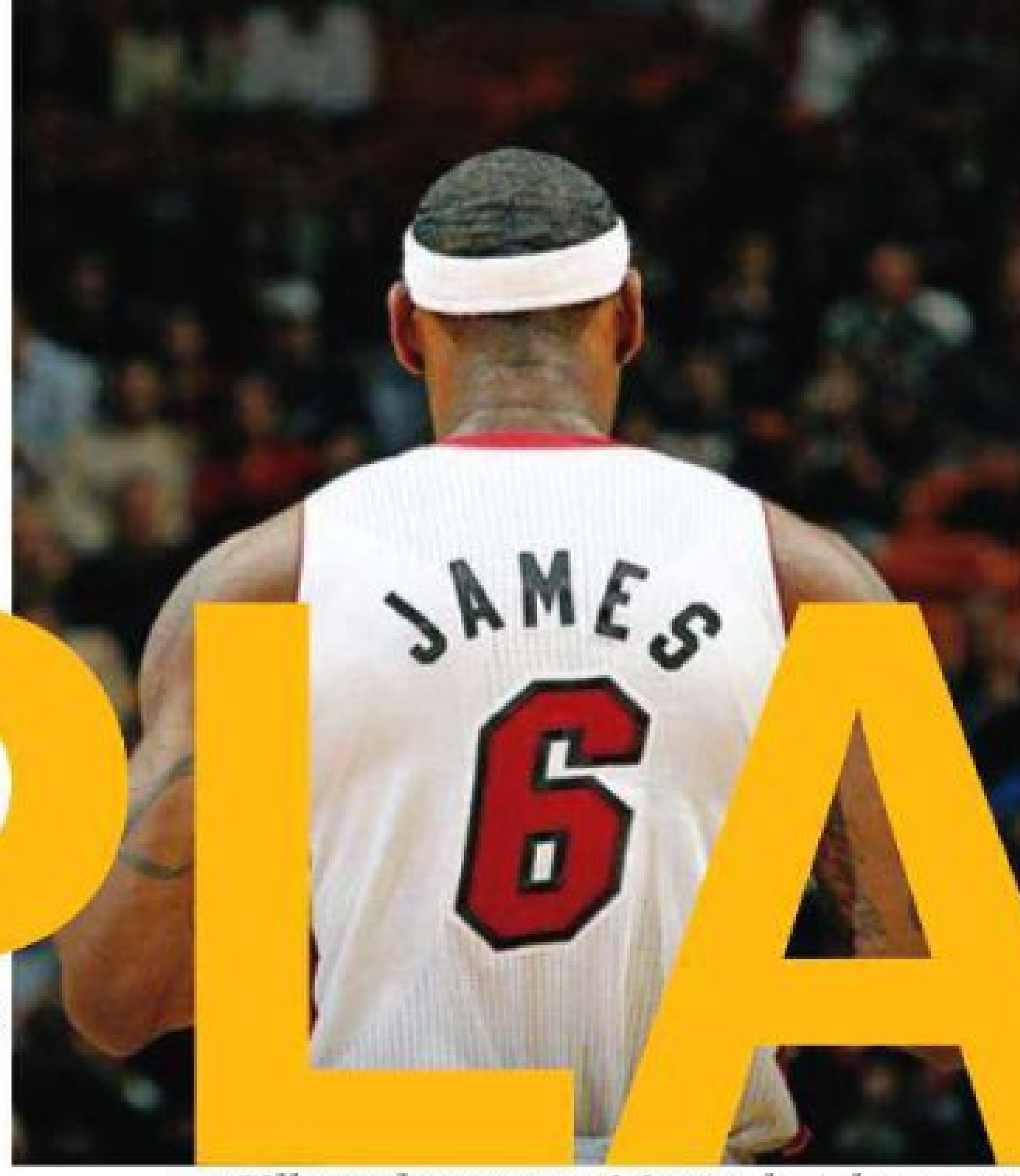
Then it happened. On July 8 the Akron kid, now a global celebrity, announced on prime-time national television: "I'm going to take my talents to South Beach and join the Miami Heat." Gilbert learned the news at the same time as the rest of the world. To call it a loss is to underestimate its financial magnitude and the personal nature of the rejection. It was a cuckolding.



Losing LeBron James may have been "a blessing in disguise."
Dan Gilbert, Cavs owner

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PLAYER THE DAMAGE

"I'm going to take my talents to South Beach."
LeBron James, Miami Heat

Gilbert began writing what became the most famous e-mail in sports history—421 furious words in the incongruously cheerful comic sans font, peppered with caps and addressed to "Cleveland, All of Northeast Ohio and Cleveland Cavaliers Supporters Wherever You May Be Tonight." He opened: "As you now know, our former hero, who grew up in the very region that he deserted this evening, is no longer a Cleveland Cavalier." "Narcissistic" and "cowardly" were on his list of adjectives. "Some people think they should get to heaven and NOT have to die to get there. Sorry, but that's simply not how it works." He guaranteed the Cavs would win a championship before the departed hero did, adding, "You can take it to the bank."

Gilbert is calmer now. In a meeting room at Quicken Loans Arena hours before the season opener, he explains how the e-mail poured out of him. He was at the annual Allen & Co. Sun Valley Conference of media and tech moguls. After watching the announcement, Gilbert wrote the letter in a couple of hours as his wife and three of his five children wandered in and out. He sent it to longtime Cavs PR man Tad Carper and a few others in the front office. "They looked at it," Gilbert says, "but I was in a state where, you know, 'post this thing now.' There were very minor changes." The response was immediate. ESPN basketball writer Henry Abbott called it "disastrous." NBA Commissioner David J. Stern fined Gilbert $100,000 and called his remarks "ill-advised and imprudent." Jesse Jackson suggested Gilbert's comments betrayed a "slave-master mentality." Mark Cuban, owner of the Dallas Mavericks and a friend of Gilbert's, applauded. "Dan's a passionate owner," he told reporters, "and he deserves a lot of credit for putting it out there. Most guys wouldn't have the guts."

For those who have known Gilbert since the early Quicken days, the letter was not surprising. "It wasn't shocking at all, heck no," says Shawn Krause, a vice-president at Quicken Loans who has been with the company for 20 years. "If it wouldn't have come out, I would have been, like, 'What's going on?'" Lindsay Gross, one of Quicken Loans' original three employees and now director of banking, says: "That's Dan, the way he's always been. He's not afraid to call it out how it is."

Gilbert says he has no regrets. "I think it pretty well matched up with how the vast majority of people in this market and this community were feeling, from little kids to old ladies," he says. He keeps binders filled with the more than 4,000 responses to his e-mail, nearly all of them supportive. He says he was shocked by the tizzy his font choice caused—he's been using comic sans in e-mails for years. As for the championship guarantee, Gilbert calls it "added motivation for this entire franchise and city." Las Vegas calls it something else. The night of the Cavaliers' most humiliating loss, the Las Vegas Hilton listed the Miami Heat as 9-to-5 favorites to win the title. Cleveland was 300 to 1.

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Obstreperous optimism is one of Dan Gilbert's signature traits. A squat five-foot-seven Detroit native, he spent a few years trying to set Michigan's steroid-free bench press record. At his peak, he weighed 165 pounds and pressed 340, and he still believes that most any obstacle, physical or logistical, can be moved with the right amount of determination. This explains why, after four failed attempts by other developers to legalize casino gambling in Ohio, he sponsored a ballot initiative that would allow his Rock Gaming to build casinos in Cleveland, Cincinnati, Toledo, and Columbus—and won approval in November 2009. It's also why he's begun moving 1,700 Quicken Loans employees from suburban Livonia to an airy new headquarters in Detroit's beleaguered downtown.

Gilbert insists that the Cavs, who are currently 5-5, will be "much, much better than most of the pundits are saying," that the departure of LeBron James may have been "a blessing in disguise," and that he would buy the team again today for $375 million. "What we've asked Cleveland and the supporters and the people to support—and they do—is the franchise and culture and the philosophy, knowing those are going to keep changing, adjusting, improving until we do find a winning formula," he says. Culture and philosophy are a lot harder to root for than a two-time MVP, but that's what the Cavs are selling. "We're Believe-land now," says veteran guard Anthony Parker. "Our identity is outworking our opponents on every given night."

It's hard to measure belief within the Cavs bubble. Outside of it, though, few people seem to think Gilbert can draw fans solely on regional pride. "There are some franchises that are there thick and thin. Think Cubs. Think Toronto Maple Leafs," says Michael J. Cramer, director of the Texas Program in Sports & Media at the University of Texas at Austin and former president of the Dallas Stars and Texas Rangers. "Cleveland is not the Cubs. And Cleveland is not the Maple Leafs."

Bob Whitsitt, an NBA general manager with the Seattle Supersonics and Portland Trailblazers for 17 years, now shepherds sports deals at Whitsitt Enterprises. He's skeptical of Gilbert's confidence. "Since he bought the franchise, he and his people have done a really good job," says Whitsitt. "I also know that once you own and are involved with it day to day, everything you look at isn't half full—it's more than three-quarters full."

NBA rules keep the Cavs' management from discussing the team's financial details. According to the numbers Whitsitt keeps, the Cavs had paid attendance of about 18,500 per game last season and an average ticket price of $70, resulting in $1.3 million in ticket sales per game. Whitsitt saw similar figures with the Trailblazers when they were a perennial playoff team. After he left in 2003 the Blazers failed to make the playoffs for five years running. Attendance fell by about 5,000 per game, to 15,000. Whitsitt says it's reasonable to expect a similar drop-off in the Cavs' performance and attendance, which would translate into a loss of about $350,000 per game, or close to $15 million over the course of 41 home games each season. Whitsitt anticipates another $15 million in lost sponsorships, concessions, and other ancillary income. Using his standard 4.67 multiplier for revenue to franchise value, $30 million in lost revenue equals $140 million in lost value. "I'm not trying to suggest, 'Hey, Dan, your franchise is falling apart,'" says Whitsitt. "But I am suggesting this would be the first time ever you've had to run a franchise without LeBron James."

Whitsitt speaks his name. Gilbert refuses to. Around the Cavs, James is a ghost. Gilbert refers to him as "the player that left," or "that one person."

Cavaliers guard Anthony Parker

"WE'RE BELIEVE-LAND NOW"

The season before James joined the team, the Cavs' average attendance was 11,500, with a base of about 2,000 season ticket holders. For now, the franchise has a cushion before the post-LeBron era truly begins. Season ticket holders renewed at a better than 90 percent clip prior to James' departure. "Very, very few people, I mean a handful, were demanding refunds or canceling after the decision," Gilbert says. Still, he acknowledges that he's in uncharted territory. "There really isn't a parallel," he says. "I cannot recall us ever losing a major, key person in a business. And it's magnified by the public nature of the business." Yet as Gilbert points out, he's weathered bigger storms. "We're a survivor of the mortgage Armageddon," he says of Quicken Loans. Three years ago, just after the Cavs lost in the NBA finals, the collapsing credit markets almost pulled the company under. "That taught me never to be naive enough to think just because you put two decades into something, just because you do it right ... " He doesn't finish the sentence.

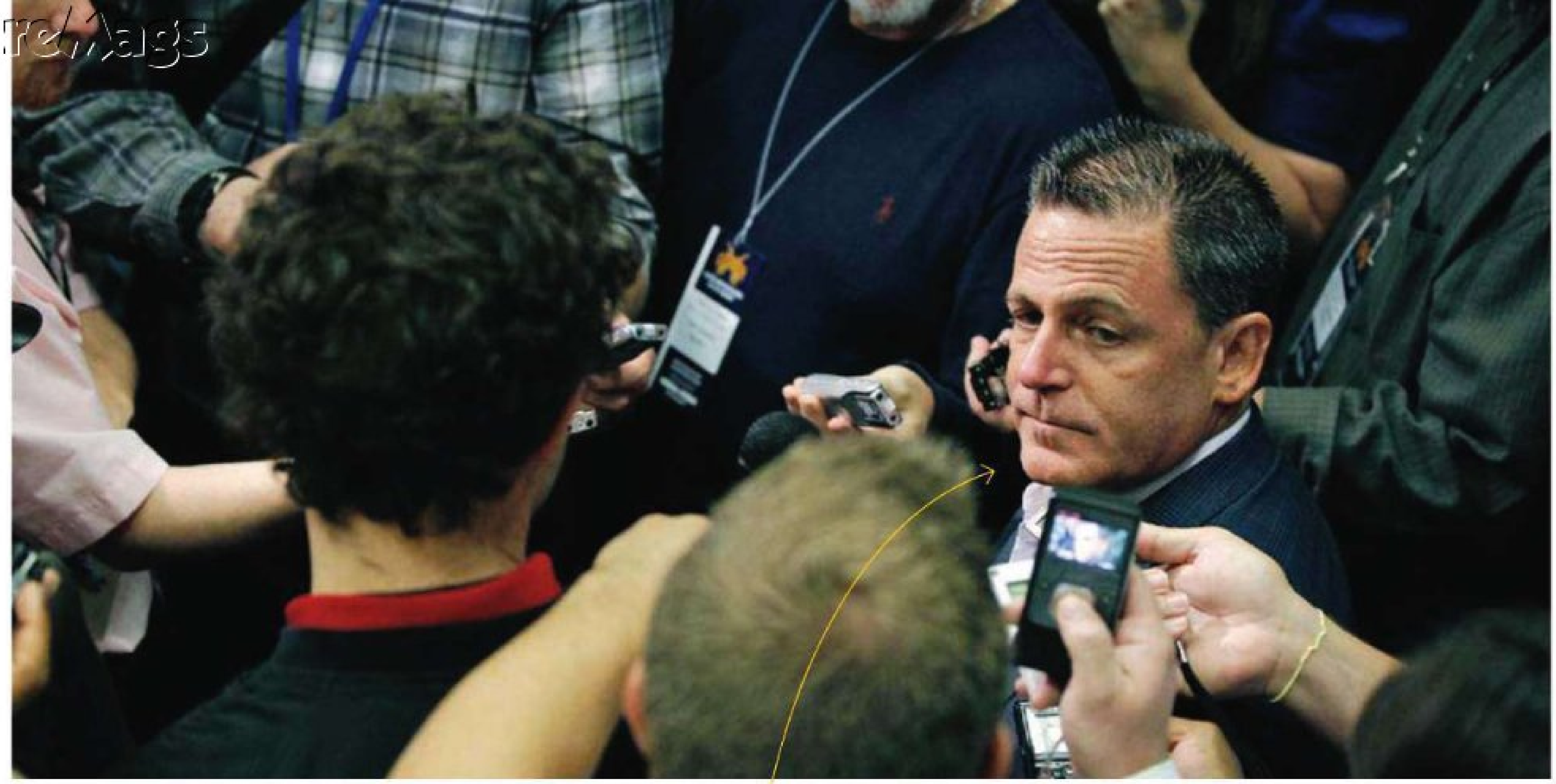
Gilbert entered the mortgage business on a whim. In 1985, during the summer after his first year of law school at Wayne State University in Detroit, he was working part-time at his parents' Century 21 realty office in Southfield, Mich. A loan officer walked in one day and suggested he try brokering mortgages. He brought the idea to his brother, Gary, and to Gross, a childhood friend and roommate for two years at Gilbert's alma mater, Michigan State, where the two hosted a local cable show called *Let's Talk Sports*. Together they started Rock Mortgage out of a rent-a-suite in Southfield. "We really didn't even know what a mortgage was," says Gross.

As he learned the business, Gilbert marveled over the fractured process of closing loans. "The home buying process in America to this very day is broken," he says. "There is still is no protocol on how a closing should work—on who calls who with the closing costs, who delivers what papers to who. Almost every closing in this country is still a Chinese fire drill, which always just amazed me."

When Rock had grown to 120 employees, Gilbert mentioned the then brand-new company 1-800 CONTACTS as a potential model. Gilbert believed a call center platform would allow bankers to go from closing 15 loans every month to 15 every day. Rock opened its first call center in 1996 and began offering a Mortgage-In-A-Box, a user-friendly loan

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application delivered, as promised, in a box. Behind the simple product was the organizational effort of mastering the loan process in 50 states and the myriad jurisdictions within them.

In May 1998, Gilbert took Rock Financial public, raising $33.3 million in its initial public offering. The following January, Rock took its Mortgage-In-A-Box concept online and began offering mortgages at RockLoans.com. By that time, Intuit, the California-based developer of Quicken personal finance software, had established an online promotional hub for mortgage lenders and wanted to get into direct lending. Rather than build its own platform, Intuit interviewed a few dozen firms and selected Rock. In December 1999, Intuit bought the company for $532 million in stock, renaming it Quicken Loans and keeping Gilbert as CEO. Gilbert won't say what he netted, but the sale to Intuit at the peak of the tech bubble vaulted him into the category of people who could buy sports teams. In December 2001, Gilbert stepped down as CEO at Quicken and moved to the chairman's office. The next month he turned 40. At a party to celebrate both milestones, according to Krause, Intuit's then-CEO Steve Bennett approached Gilbert with a proposition. "After Dan got done speaking and the thing was over," says Krause, "Steve came to Dan and said, 'Do you want to buy the company again?' "

Intuit sold Quicken Loans to Gilbert's Rock Financial for $64 million in August 2002. Quicken, now a private company, continued to ride the expansion of consumer credit. By 2005 it had 2,000 employees. Two years later, credit agencies began to downgrade shaky mortgage assets. "It was the first Tuesday in August that all hell broke loose," says Krause. "Dan sent an e-mail: 'Get a war room set up overnight and we'll be in here first thing tomorrow morning.' "

Quicken executives, CEO Bill Emerson says, stayed in the room 18 hours a day for 8 weeks until they had sorted through the worst of the problems. The company quickly shifted to making only loans that matched Fannie Mae and Freddie Mac guidelines. "We turned this thing around in a week and went from some of the stuff that we were originating to a 100 percent Fannie-Freddie shop," says Emerson. This year, thanks to the boom in refinancing, he says the company is on pace to surpass last year's $25 billion in loans closed.

Krause, like Gilbert, sees parallels between the mortgage crisis and the Cavs' loss of their superstar. "Companies were in the fetal position, just giving up," she says. "Here we hunkered down and looked at what companies can we buy, what's the best thing to do. That's the same that [Gilbert] did with LeBron. It's like, 'O.K., this is a challenge.' "

As an NBA owner, Gilbert studies past teams as case histories. His current favorite model is the 2004 Detroit Pistons, a defense-minded team that won a title without a superstar. The Pistons, though, are an anomaly. Teams with players named Michael Jordan, Hakeem Olajuwon, Shaquille O'Neal, Tim Duncan, Dwyane Wade, and Kobe Bryant have won 18 of the last 20 championships.

Many believe the Cavs will have to sink before they rise—that they should shed their most expensive players and accept an abysmal season or two to give themselves a better chance at signing another star in the free agent market or picking one up in the NBA draft. (Losing with abandon was how the team put itself in a position to get James in 2003.) That route is chancy at best. Only teams that don't make the playoffs get in the lottery for the top picks in the draft, but the final order is decided by bouncing ping-pong balls. Players like James don't come around every year.

In the Cavs' locker room after the opening game, James's image suddenly appears like a ghost on one of the flat-screen TVs. It's a new Nike ad that begins with a re-creation of James' *Decision* special on ESPN. James turns to the camera and asks, "What should I do?" Scenarios unfold—James as a cowboy villain, a poet, and co-star with Don Johnson on *Miami Vice*—before he finally asks, "Should I be who you want me to be?" On his jet the next day, Gilbert admits to being baffled. "I don't even get it," he says, "I really try to understand."

"That's Dan, the way he's always been. He's not afraid to call it out how it is."
Lindsay Gross, Quicken Loans' co-founder

Earlier that morning, Gilbert received an award at a luncheon thrown by the Downtown Cleveland Alliance. On the van ride over to the Huntington Bank building, he frantically preps his acceptance speech. He hasn't read the file put together by his PR team.

Gilbert extemporizes for half an hour, rambling about the Cavs and his casino plans until eventually he finds his theme: Downtown Cleveland needs more people. Reversing the flight of young people from the Midwest to the coasts is Gilbert's great cause, and the symbolism of the departure of the player that left is not lost on him. "Cleveland is a great community," he says in closing. "Let's make it even better. Let's make it to levels that people will be shocked about—including those who went to South Beach." Ⓑ

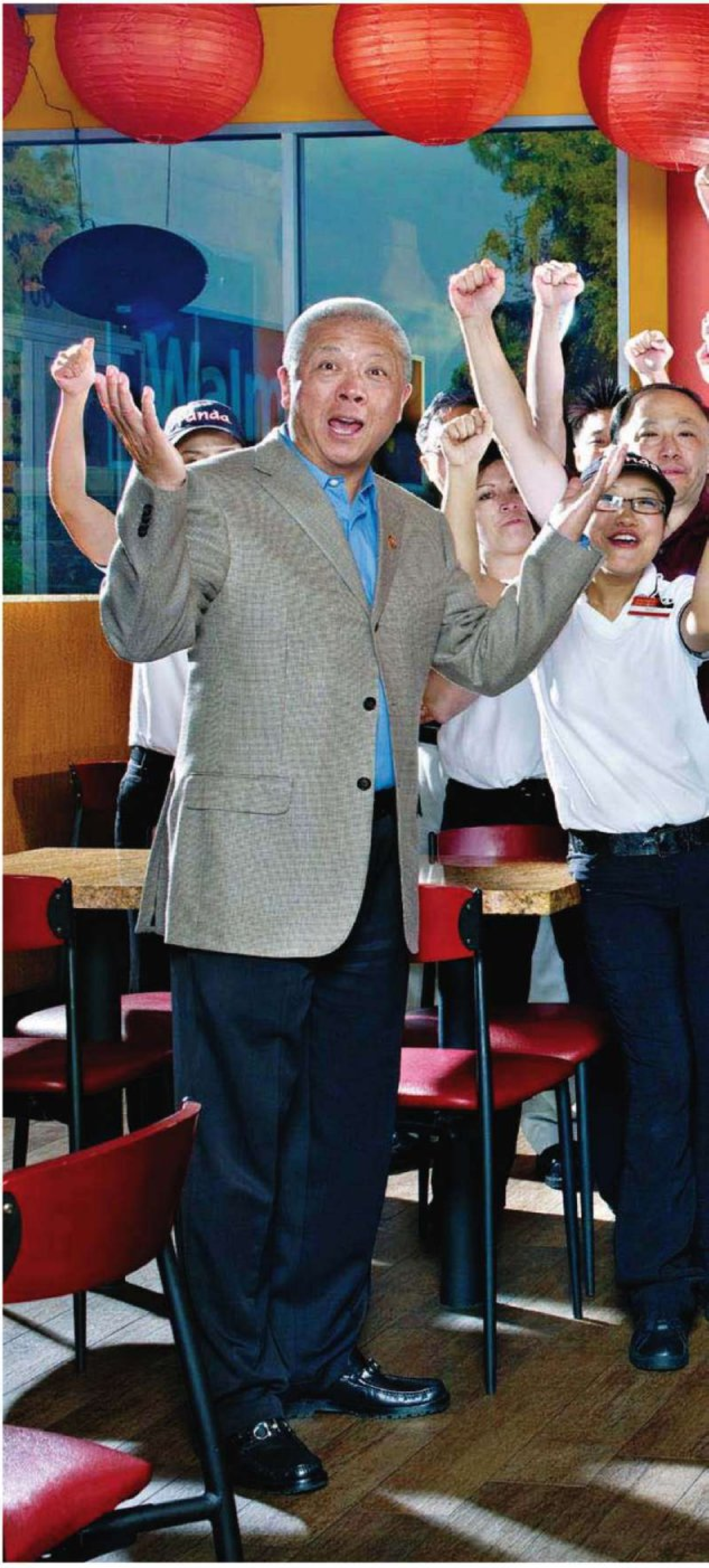
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THE SHARIN' HUGGIN' LOVIN' CARIN' CHINESE FOOD MONEY MACHINE

Fast-food chain Panda Express is turning self-help tenets into serious cash flow.
By Karl Taro Greenfeld
Photograph by Jeff Minton



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Andrew and Peggy Cherng with the Rosemead (Calif.) Panda Express staff

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The Pandas are in an affectionate mood. Seventy-one Panda Express managers are gathered in the banquet room of the Dynasty Restaurant in San Jose, Calif., waiting in line to make a commitment in front of their colleagues to improve themselves—and the business. They are wearing orange T-shirts advertising their newest entrée, Kobari Beef. "I'm feeling saucy," the shirts read.

They call themselves "Pandas" because they are employees of Panda Restaurant Group (PRG), a privately owned, 1,350-location "fast casual" Asian restaurant chain with $1.4 billion in annual sales. Part of being a successful Panda is buying into a process that founder and Co-Chief Executive Officer Andrew Cherng, 62, calls "a continuous commitment to sharpening yourself." That means standing before your fellow Pandas and speaking honestly and openly about your personal and business failings. It also means a lot of hugging. Here is a typical share by Tina, who is from store 538: "I didn't have a good relationship with my dad. We didn't talk, and he treated me unfairly, I always thought. If he called, I wouldn't pick up. I wouldn't call him back."

Tina begins crying, her voice faltering. "I didn't realize that I was hurting myself by holding on to what happened in the past. I needed to let that go. I can't keep this anger inside me because it just hurts me, it keeps me a prisoner. I have to let that go to go forward. That's the commitment I am making."

When she is done and returns to her seat, she is embraced by a half-dozen fellow Pandas, including Cherng, who nods at the progress she is making.

Cherng is an avid consumer of self-improvement programs. He urges his Pandas to maintain healthy lifestyles and eat a well-rounded diet; he recently challenged the Pandas to run three miles in under 36 minutes. He has since 2003 been a participant in Life Academy, a Taiwanese organization that follows a "life manual" dedicated to the "advancement of the human spirit." He is a devotee of Stephen Covey's *Seven Habits of Highly Effective People*, Deepak Chopra's *The Seven Spiritual Laws of Success*, and Don Miguel Ruiz's *Four Agreements*. Recently, Cherng has become passionate about the Landmark Forum, a program that utilizes Werner Erhard's EST methodology, which *Psychology Today* described as one that, "tore you down and put you back together."

According to the group's literature, Landmark improves everything from personal relationships to business performance. It is a kind of program Cherng has been relying on for almost a decade. "I see the benefit of Landmark to the human race," he says. "If you quit Panda tomorrow, I still want you to go to Landmark."

During the sharing, it becomes clear that every one of the 71 managers present has already attended the introductory Landmark Forum and many have completed the Landmark Advanced Course and Landmark Communication Course as well. The classes are intensive, three-day sessions where participants are urged to shed their past, break down obstacles to personal growth, and "bring about positive and permanent shifts in the quality of your life."

Cherng, perhaps emulating the Landmark coaches he has learned from, runs his regional meetings more like encounter groups than corporate conferences. He stands in the back of the room, arms folded, nodding as he listens to his managers share their pain, sorrow, joy, and pleasure, and pumps his fist when he hears an inspiring share. He has silver crew-cut hair, a round face, appraising eyes, and a slight underbite, all of which are reminiscent of an Asian Pete Rose. He wears casual clothing, today a Patagonia hoodie, khakis, and loafers. As he paces the rear of the banquet hall, crossing back and forth in front of the breakfast tables, he nods his head and devotes himself to "active listening."

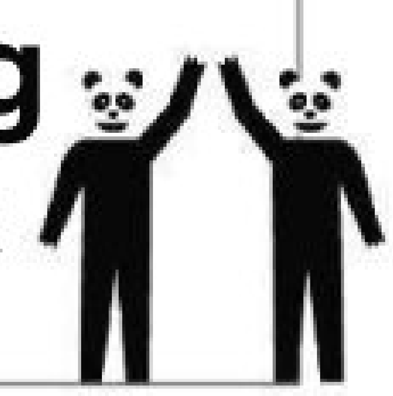
At the end of the meeting, Cherng throws up a PowerPoint slide comparing Panda Express to a variety of restaurant chains. Right now, he explains, Panda is averaging about $1.4 million in annual sales at each of its 485 California locations. In-N-Out Burger is averaging $8 million to $10 million at its best locations.

"We need to be at $2 million per store," he says. "I'm challenging all of you to be impeccable, to aim higher, to grow!" Cherng's belief is that the personal improvement of his staff—by dieting, working on communication skills, running faster, and, of course, attending seminars—is directly transferable to sales. "I challenge you," he repeats."I challenge all of you to grow."

The Panda Express story is many great American stories all in one. It is the classic immigrant story: Cherng and his chef father, Ming Tsai Cherng, who died in 1981, were fresh-off-the-jumbo-jet Chinese émigrés who built an empire one location at a time, starting with a Panda Inn in Pasadena, Calif., in 1973. It is also the great American entrepreneur story of a little guy borrowing $30,000, opening his own business, and working seven days a week to make it a success. It is the story of a happy marriage that is also a thriving business partnership. Cherng met his wife, Peggy, who has a PhD in electrical engineering from the University of Missouri, before he opened his first restaurant; she would work with him not in the kitchen but in the finance, logistics, and systems areas of the company.

Cherng and Peggy, who both hold the titles of co-chairman and co-CEO, preside over one of the fastest-growing and most successful restaurant chains in the U.S. In a challenging economy, the company is on track to record same-store sales growth of 7 percent this year. It is one of the largest privately held retailers in the U.S., with ownership of 99 percent of its locations. Cherng plans to add 75 stores this year and 100 in 2011 as part of a long-term plan to get to 2,300 stores by 2015. Next

Cherng's belief is that the personal improvement of his staff—dieting, working on communication skills, jogging, and attending seminars—increases sales

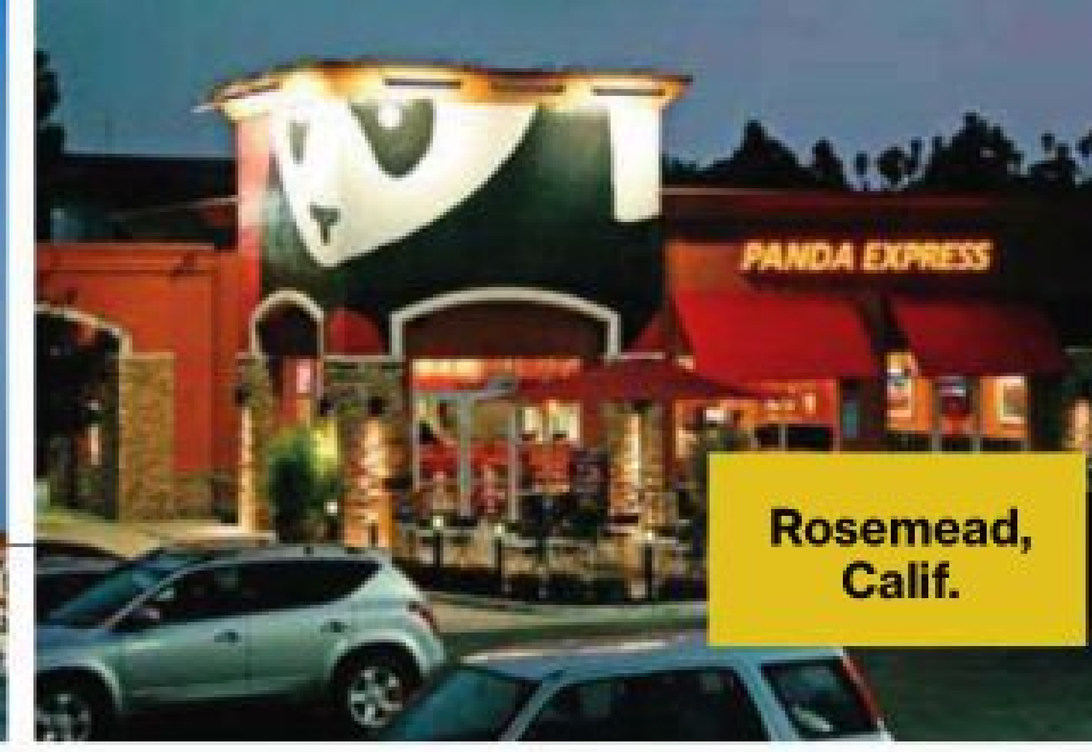


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year the company will expand into Mexico—part of a joint venture with a partner to be announced—with plans to launch 10 stores in 2011 and an eventual goal of 200 stores. Cherng is also diversifying beyond the food business and intends to open 150 Tide-branded dry cleaners in partnership with Procter & Gamble.

The restaurant industry in general has been suffering through two years of declines, but the sector called "fast casual," which is basically non-burger fast food, has bucked the trend, according to Bonnie Riggs of NPD Group. The research firm reports that for the three-month period ended in August, Asian-themed fast casual food was up 4 percent, while the industry as a whole was flat. "Panda drives that category," says Riggs, noting that Panda is 10 times larger than its nearest competitor. With no true national competition in its category, Panda Express now sees the giants of the fast-food industry—McDonald's, Taco Bell, Burger King, and the like—as its main rivals.

Still the company faces challenges, which Landmark may or may not be able to help. "Asian is the new Mexican," says Glenn Lunde, senior vice-president for marketing. "It's fresh, exciting. It's what Mexican food was in the '90s." The problem, as Lunde sees it, is getting to 2,300 locations without losing the culture of the business. "Growing is easy," he says, pointing out that the company is entirely self-funded. "But it's doing it right; it's not turning it into another Taco Bell." Lunde should know, he spent eight years at Taco Bell.

The other option, moving up-market and taking on PF Chang's, is not viewed as an appetizing prospect. PF Chang's, with 200 locations, is a sit-down restaurant that has also had a phenomenal run these last two years. "We want to stay right where we are. PF Chang's is the McDonald's of their space. Let them have it," says Lunde. PF Chang's has tried to move down-market into Panda's space, opening Pei Wei, but has found it hard to sell cooked-to-order meals quickly and cheaply.

"The lunch crowd can't wait," says Lunde. The Panda breakthrough, as he sees it, was figuring out how to serve appetizing Chinese food—and fast. The cafeteria-style steam table was the key, but the problem was making food served in that manner look fresh and appetizing. Cherng's innovations were simple: the huge cooler full of fresh vegetables that you see at every Panda and the open kitchen design that lets the customer view the food as it's being chopped, prepped, and cooked. The impression one gets, even if the food has been in the wells for 45 minutes, is of freshly prepared food. It is similar to the approach taken by Subway or Chipotle Mexican Grill. Somehow, the consumer believes that if he can see the ingredients, then the ingredients must be of higher quality. Although the Panda model at heart is much like a college cafeteria—you pick up your tray, move down a line, and choose your food—it doesn't feel that way, and that is where Andrew and Peggy cracked the casual dining code.

In traditional Chinese restaurants, where Cherng got his start, there is a strict division between what is called "FOH," or the front of the house, and "BOH," the back of the house. FOH are waiters, busboys, and, most important, the manager who keeps the dining room running smoothly. BOH are the cooks and prep chefs who prepare and hand over the plated food to the FOH staff. Cherng is the quintessential FOH man. He is joyous, optimistic, glad-handing, and even here, in his office suite on the second floor of his Rosemead (Calif.) corporate headquarters, he has the welcoming and eager-to-please manner of a bow-tied maître d' on opening night.

In his office, he is surrounded by a sculpture of a golden Buddha; a sculpture of a dragon; a basketball signed by John Wooden; and framed photos of his three daughters with their families. His bookcase is filled with self-help titles. Even back when he had just one restaurant in Pasadena, his waiters recall him bringing in cassettes of the latest business management seminar he had attended. Years later he moved from management to personal enlightenment. "For a while it was Seven Habits, then Life Academy, then Landmark," says Alan Huang, senior vice-president for operations and a Panda since 1988. "I rebelled in the beginning, but Andrew kept pushing so I went."

"Business is a playground," says Cherng, sitting down. He takes a moment to think before he reverts to his customary smile. "Business is where you practice your human skills. It's where you grow. You have to grow! You grow as a person, and then you will grow in business. That's how you go forward."

Spending time with the Pandas is unlike visiting almost any other corporation. Where else will an employee walk up to you, as one store manager did to me during a corporate meeting, give you a hug, and say: "Hi, I'm Francis Yee, and I'm making a commitment to being more open."

Cherng is unapologetic about his focus on what he calls "personal growth." "Before 2003 we used to be more task-based," he says. "But now, if you want to be a manager at Panda, you

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have to be committed to being positive, to continuous learning."

Eugene Lam, a regional vice-president managing 340 stores, says that joining Landmark isn't mandatory. "Every now and then we have some individuals who say all they want to do is work and go home and do nothing," he says. "But those people will eventually feel like they won't catch up, they'll feel behind in the workplace."

Cherng became successful before he sought to understand the mechanisms of his success. Only in his 50s did he begin to wonder at the components of business and personal success and invest his time in self-help movements. "We just did it, never thought about not doing it," he says. "I would never leave the restaurant. I developed kidney stones from standing so much. I forgot to drink enough water. Just standing, waiting for the customer."

Cherng grew up in Taiwan, the son of a chef who had fled with the retreating Kuomintang from the mainland in 1949. The Cherngs moved to Yokohama, Japan, in 1963, when his dad, Ming Tsai, got a job at a Chinese restaurant in Yamashita-cho, part of Yokohama's vast Chinatown.

Cherng was an indifferent student. "My best subject was playing pool," he says. "There was a club next to the school, and I would be in there all day." He quickly decided he had to get out of Japan. As an ethnic Chinese, his options there were limited. "There's a line, you know," he says. "If you're not Japanese, you can't cross that."

"America seemed like the next right thing. I don't know why. It just felt like something I had to do," he says. The obstacles facing a young Chinese person who wanted to go to college in the U.S. were formidable. "I couldn't take SATs," Cherng recalls, "I couldn't even speak English." He heard about a college, Baker University, in Baldwin City, Kan., that didn't require SATs. He "manufactured" his high school transcript—"I gave myself good grades"—and had his high school principal sign off on the document. "Did he read it? He didn't care. These are the kinds of things you need to get done, you figure out how to get it done."

He went to the U.S. by himself and recalls 1966, that first year in Kansas, as one of the loneliest of his life, saying: "We had no phones. A letter would come from my family, and I would read it five times over. And my mother and father didn't know how to write, so they would get somebody to write for them. People left the dorm for Thanksgiving. I didn't leave. Nobody was left but a few Chinese still in the dorms."

He could only take mathematics courses—his English wasn't good enough for any other subject—but he discovered that if he took German, he could learn English and German simultaneously, since he was proficient at neither. The summer of 1967, the Summer of Love, was for Cherng the summer of working as a waiter in a Chinese restaurant in Brooklyn. He began to work every summer, every winter, every break, saving up money for tuition.

This was when he discovered his knack for working the front of the house, at Chinese restaurants like The Shanghai Door on 94th and Broadway in Manhattan. He also realized, like thousands of his countrymen, that Americans seemed to have an insatiable appetite for Chinese food. His sophomore year at Baker College, a freshman from Hong Kong arrived, Peggy Tsiang, a fellow math major. "We were in the same class," says Peggy. "I was 17. Being foreign students, we were both adjusting, there was a lot of adjustment. It wasn't love at first sight... but he was a very attentive person."

The two would go on to graduate school together at the University of Missouri, where Andrew earned a master's in applied mathematics. Afterward, Peggy stayed in Columbia, Mo., earning her PhD, and Andrew moved to Los Angeles to manage his cousin's restaurant, Ting Ho, in Hollywood. "I was making $800 a month," he says. "The restaurant was open six days a week. I told my cousin we have to be open seven. That was not so smart. We opened seven days, and I was still getting $800 a month."

When his parents joined him in the U.S. in 1973, Andrew figured out he had a great BOH man, a master chef, to go along with his own FOH skills. He heard about a restaurant on the east side of Pasadena that had closed. Cherng put up every dollar he had saved, took out a $20,000 bank loan, and borrowed $10,000 more from a waiter he worked with at Ting Ho. It was this waiter who suggested the name Panda. This was the era of Nixon going to China, the opening of bilateral relations, and the first pandas turning up in American zoos. "Americans like pandas," the waiter reasoned.

"I was so confident," Cherng recalls. "I remember there was this restaurant down on Walnut, Sangs, and they were selling a hundred pounds of bean sprouts a day, just loading every dish with bean sprouts. I thought, 'Who wants to eat that?' And they were busy. So I thought, you know, because of my father, 'I've got better food.' But then that month, two other Chinese restaurants opened, across the street from me and a few blocks away. I'm like, 'Jesus, how unlucky,' but that's how life works."

If you had walked into the Panda Inn in 1973, you would have found very little to differentiate it from most other chop suey joints. The décor was a little brighter, the food a little better, but for most customers, it was just another Chinese place. Gradually, by simplifying his lunch menu to include the dinner favorites at 60 percent of the price, but charging customers for rice and other extras, he began to build a steady following. "By 1977," he says, "they were lined up lunch and dinner, lined up!"

He opened a second restaurant, and then a third in 1982, all with sit-down dining rooms. In 1983 he opened the first Panda Express in the Glendale Galleria mall. Before opening, he pulled his chefs together and forced them to come to a consensus about the preparation steps and ingredients for each dish. "I told them, 'You stay in that kitchen and don't come out until you agree on one recipe,'" he says. From those meetings he developed a number of recipes, in-



The Cherngs at their engagement party in 1972



The elder Cherngs in Taiwan in the 1960s

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cluding Orange Chicken, the signature dish of the franchise, which is ordered by 75 percent of Panda customers. (To serve it, PRG goes through 65 million tons of chicken a year.)

Expansion was slow but steady, with two more stores in 1985, three in 1986, and three more the next year. By 1992 there were 97 stores, and revenue was growing at 33 percent a year. Cherng also came up with the open design and colorful décor, dotting the interior with red paper lanterns, all novel ideas in the Asian food industry, which had been dominated by mom-and-pop operations that didn't always put a premium on design. Yet all of Andrew's vision may have run up against the hard realities of logistics if not for his wife. "In the beginning, we said we wanted to be the McDonald's of the East," says Peggy. "But what he didn't realize was that we had to standardize everything, from recipes to kitchens. That's the difference between us. I think process, systems. He's the visionary."

Peggy's office is around the corner from Andrew's. On her desk is a copy of *How to Win Friends and Influence People* by Dale Carnegie. When asked how she likes it, she shrugs and says: "It's kind of another *Seven Habits*." Peggy is a pretty woman with short black hair and smooth, pinkish skin. She has a gentle voice but becomes impatient when discussing concepts that can more quickly be explained with a chart or a graph or a time line. Asked about when certain developments happened at Panda, she goes to a computer and starts opening PowerPoint slides.

Before Peggy joined her husband at Panda, she worked at Comtal/3M as a software designer. Before that, she was at McDonnell Douglas. "I was doing computer systems that helped to build missiles," she says. She was, in other words, a rocket scientist.

When she joined Panda full-time in 1982, just as the company began its rapid expansion, she brought with her a systems expertise that allowed Panda to deploy technology like a point-of-sale system that allowed each restaurant to track inventory and automatically reorder ingredients. Peggy wrote some of the software herself and eventually headed the expansion of the program and terminal into the robust and patented PAWS (Panda Automated Work Station) system that is now in every store. PAWS allows for real-time tracking of inventory, sales, and customer preferences throughout the entire company.

Kobari Beef was originally called Panda Beef. Says the head of marketing: "People thought we were actually serving Panda"

"This was the only Chinese restaurant using computers," says Gigi Cheung, who joined Panda as a waitress in 1986. She would work her way up to executive director for compensation and benefits, reporting directly to Peggy. (And yes, she has done the Landmark Seminar, as have all 12 of her staff.) "The standard was higher here," says Cheung. "The system was already in place: teamwork, technology, even the bonus system."

Peggy would come up with the human resources software, oversee much of the financial planning, secure the credit lines the young company needed, and even work on streamlining the kitchen. She oversaw the creation of Panda's "K-Minus" system, which entails doing as much prep as possible before the food hits the kitchen. She says things like, "We needed to K-Minus the sauce." At Panda, the sauce is premixed, in bags. She also figured out ways to K-Minus the meat and the veggies. Andrew, the visionary, the Front of the House man, just wanted to open more restaurants, expand, and attend his self-help classes, but it was Peggy's technological knowhow that allowed it all to proceed as smoothly as it did. It was Peggy who figured out the Back of the House.

Perhaps Cherng's obsessions with personal growth stem from his desire to keep himself motivated as his company, already worth billions, continues to expand.

To reach Cherng's goal of $2 million per store in annual revenue and $2 billion in total sales, the company is going to have to make some changes. Lunde, the highest-ranking Caucasian in a company dominated by Asians and Latinos, believes he can improve sales by tweaking the menu. Lunde is a creature of the fast-food industry. At Taco Bell, he came up with hit products such as the Chalupa and the Gordita. He joined Panda in 2005 and has since created two recent popular additions to the Panda menu, Kobari Beef and Honey Walnut Shrimp. Kobari Beef is based on a dish originally served at the Panda Inn, where it was known as Panda Beef. "We focus-grouped it and found that some people thought we were actually serving panda," says Lunde of the name change. Lunde is best known for his judicious use of one key ingredient: bacon. "I put bacon in everything," he explains. He worries that to expand the business, the chain might need to move into breakfast meals–not a natural area for an Asian-themed restaurant–and add even more bacon. So far, experiments with bacon-cheddar *bao*–steamed buns–have not met with much success.

Cherng still sees the company's growth more in personal rather than professional terms. Reaching his goals, he believes, means "better service, better execution, better environment. Every one of these things requires a human touch. ... Every one of these things benefits from Landmark. .... Forget about return on investment. This is a tremendous overall contribution to society."

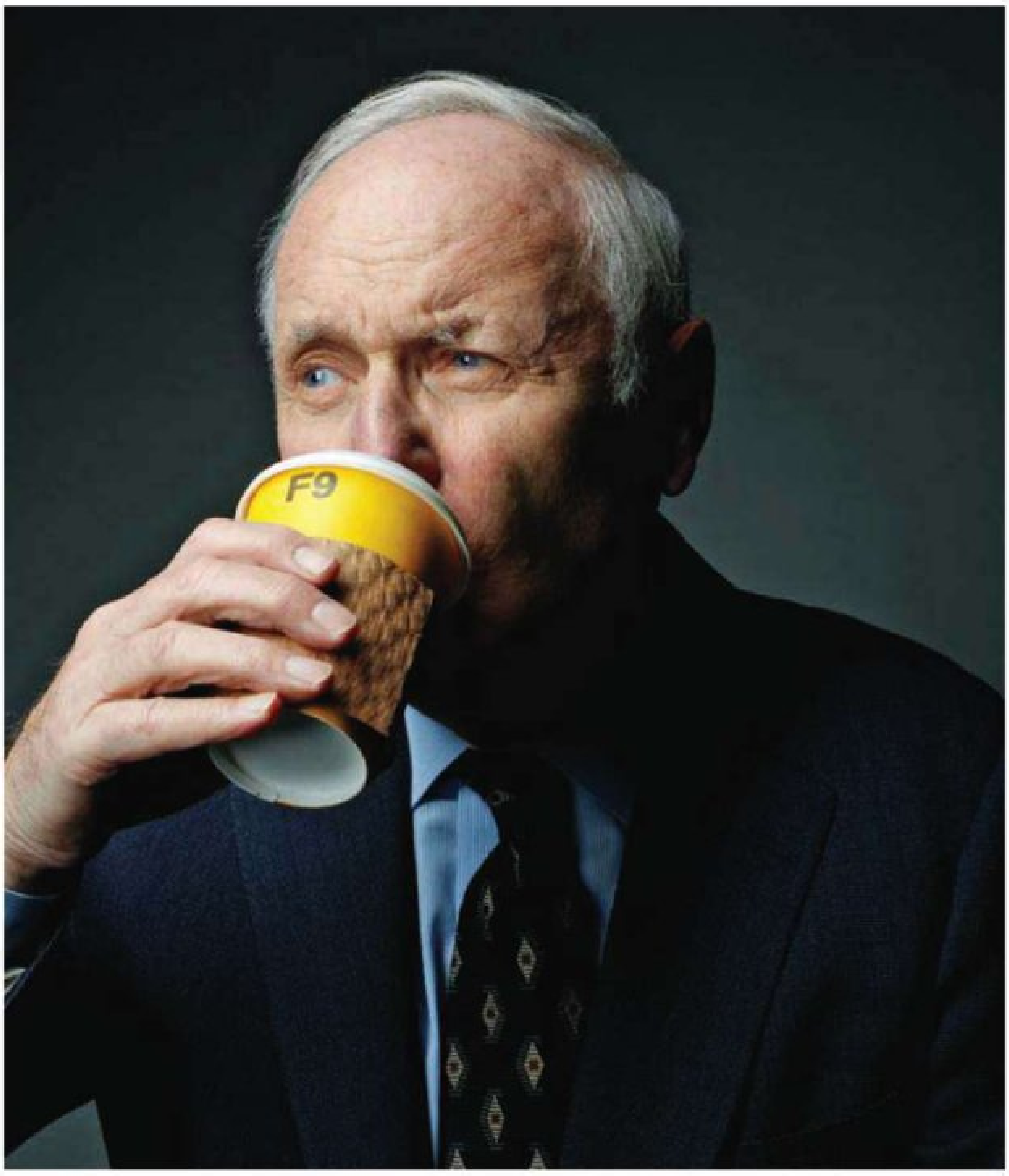
At a mall near the airport in San Jose, Calif., Cherng pauses before visiting a Panda Express at the end of a strip that also houses a waxing salon and a frozen yogurt shop. He nods his head, saying, "This is a good-looking store." He poses for photos with his staff and then greets confused diners. "Thank you," he says. "Thank you for coming."

Two young men and a middle-aged woman, on their lunch break from a nearby office, look at him and nod back. "He must work here," says the woman to the one of the men as they walk out through the glass doors.

As they leave, Cherng walks over to the table where they were sitting, picks up a grain of fried rice from the table, and takes it to the garbage bin. He may no longer spend his days behind a podium in a bow tie and suit anxiously awaiting the lunch crowd, but he will always be a Front of the House man. B

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KARL'S KINGS OF INDUSTRY

It's tempting to think of Karl von der Heyden as the Zelig of 20th century business. He served as chief financial officer of three large consumer products companies—PepsiCo, RJR Nabisco, and H.J. Heinz–and sat on 10 boards including the New York Stock Exchange, DreamWorks Animations SKG, and Macy's. Along the way he worked for Tony O'Reilly, Lou Gerstner, Roger Enrico, and Henry Kravis, to name a few. The only problem with the Zelig comparison is that von der Heyden was no bystander. He was a strategist and counselor making crucial decisions at crucial moments. Or, as Enrico puts it, "Karl was my gift from God." Born in Berlin and educated at Duke University and the Wharton School, von der Heyden, 74, is now co-chairman of the American Academy in Berlin with Henry Kissinger. Earlier this month, a few days before von der Heyden was inducted into the Financial Executives International Hall of Fame, Norman Pearlstine, *Bloomberg Businessweek* chairman and president of the nonprofit American Academy in Berlin, sat with von der Heyden to discuss big brands and big personalities.

You were in charge of the financial strategy and performance of three major consumer products companies. When you were growing up in Germany, is that what you thought life was going to be about?
I actually wanted to be a journalist, if you can believe that. I had an uncle who was an entrepreneur. He didn't say I shouldn't do this. He said, "maybe you should consider being a business journalist." He then suggested that I do bank training, and once I got into business, I was hooked.

How did you end up at Duke?
I came in '57. My brother suggested I study in the U.S. because English is the most important language and, if you're in business, you have to think globally. He helped me get a scholarship to Duke. I enjoyed Wharton tremendously, too. It was intellectually challenging, but I had a great time.

Then I worked for Pitney Bowes in Stamford, Conn. They were just going international: England, France, Germany. I set up the finance function in those countries. Eventually I became corporate comptroller. It was well run. They had a monopoly with the U.S. Post Office. They made a lot of money with these postage meters. What they failed to do is think strategically. They wanted to get into the copier business, the business of cash registers, and all kinds of other businesses. And they failed miserably in all of those. They were not thought through strategically. They're still around, but they haven't really evolved.

How did you get to PepsiCo?
A tennis buddy of mine was a headhunter, and he called one day and said PepsiCo is looking for a comptroller. Pepsi Cola had merged with Frito-Lay, and Don Kendall engineered this merger. It was a true merger of equals, which you rarely see. Nobody took over anybody. We had two of everything. What we didn't have was a corporate office. I was ushered into an office that was completely empty except for a phone and a desk. I was really the first comptroller they ever had at Pepsico. Then I was moved over to the Pepsi-Cola division as CFO.

You reported to John Sculley, who went on to become CEO of Apple.
He was a very interesting guy, very nice and incredibly creative. He would come every Monday morning with a whole list of ideas that he had over the weekend, and he wanted every one of them to be implemented immediately. We all listened to him. And then after he left,

PHOTOGRAPH BY MIKE MCGREGOR FOR BLOOMBERG BUSINESSWEEK

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we would decide which ones were really good ideas and which ones were not. As far as I can tell, John never followed up on any of these things. He was already on the next idea.

What was Don Kendall like as a CEO?
He had started as a syrup salesman. He knew all the bottlers personally, and if a bottler called, no matter how small, he would interrupt anything to take that call. He would always call back himself. That taught me a little bit about customer orientation, which this guy really had. And, of course, he got Nixon to steer Khrushchev to the kitchen and ...

There was a Pepsi-Cola waiting for him.
Yes. That picture became world famous. It was arranged, but you couldn't predict whether Khrushchev would do it. Kendall was very fortunate. He was more opportunistic than strategic. Russia, for example, interested him. Pepsi became the first consumer product in the Soviet Union, and for many years was the only one.

How did you end up at Heinz?
What interested me in that case is that I could be CFO of the whole company, and I could join the board. [Chief executive officer Tony] O'Reilly been there less than a year. We hit it off in the interviews. But we had a hiccup on the first day of the job. The comptroller of the company came to me and said, "I made a stupid mistake. I charged a lot of my personal expenses, including gambling at Las Vegas, to the company. It won't happen again." I said, "Well, I understand that, but you can't really work for me." He walked out and within two minutes I got a call from Tony O'Reilly to come to his office. He said, "I told him that he can redeem himself. What are you doing interfering with this?" And I said, "He can't work for me."

You said that the first day?
First day. He felt he had been overruled by somebody he had just hired. So there was silence for a while. Then the same guy's bad judgment showed up again, and he was fired. After that, it went fine.

You left for RJR in '89, when the barbarians stormed the gate. RJR is acquired by KKR, and Lou Gerstner comes in from American Express as CEO.

They had to track me down, I think, in Sweden. The headhunter begged me to at least meet with Lou Gerstner at his home in Greenwich, which I finally did, and even then I turned him down, because I had so many [stock] options at Heinz.

With O'Reilly, I was in his home in Pittsburgh all the time. We always had a drink and played rugby on his lawn. Gerstner is the total opposite. The only time I was in his home was when he tried to recruit me to RJR.

How good was Gerstner at conveying gratitude or respect?
Lou had an awkward time with it. He was really focused, and he didn't expect his top management group to be looking for warm and fuzzy things. It's sort of like how a good football coach expects pros to play. You had to be self-motivated. He was a great delegator [though]. When he found out that I had done a lot of work in Russia, he said, "Oh, great, I don't want to do that. You take that over." After that, I never heard about it. I just did it. I established a very good relationship with him. Our offices were next to each other. I could go in there and tell him, "Lou, you're full of s--t," and he would take it one-on-one. Not in a meeting, though. Usually the meetings were with divisional people, and so you kept your powder.

With Heinz you had shareholders and a board. Here you were owned by private equity. Do investment bankers really know how to run a business?
No, and the good news is that Henry Kravis and George Roberts knew they couldn't run a business. They told Lou that they needed somebody like him immediately. Otherwise, they kept corporate governance as if it were a public company. We had a board with outside board members. When it did go public again, it was not a big thing.

Are they thinking about the exit multiple from the day they take over?
I believe so. For them it's just numbers. They look at the exit before they even buy the company. I was later on a board of a private-equity-owned company as an outside director and I said, "We should have a strategic plan." They all nodded, and six months later the company was sold. I was so naïve. It's a totally different world.

There was initially a lot of justification for private equity, because they could find these poorly managed companies. By putting in good management and cutting expenses and having huge leverage, they could turn it and make a huge profit.

THE GOOD NEWS IS THAT HENRY KRAVIS AND GEORGE ROBERTS KNEW THEY COULDN'T RUN A BUSINESS

Was RJR your toughest challenge?
We almost went under at RJR because the junk bond market collapsed on us. When I came in, over 50 percent of the debt had to be refinanced within one year. And we couldn't refinance. Then the issue was the tobacco business. We started having trouble attracting good marketing people to the food side of the business, because they didn't want to work for a tobacco company. One of my early pushes was that we need to split the company and spin off Nabisco. Strategically, they shouldn't be together. I proposed that we spin off Nabisco, give it a normal debt structure, and keep the rest of the debt on the tobacco business, because they could afford it.

KKR interfered on this one?
They interfered. When RJR was bought, it went from a AA credit rating to junk. That created a lot of friction with bondholders, and the rating agencies also were totally surprised. They came back and said, "We can't really trust you guys." So the KKR guys, who had other companies to worry about and their image with the rating agencies, objected to spinning off the food business–not because it wasn't the right thing to do for RJR Nabisco, but because it wasn't the right thing to do for KKR.

One of the things that private equity likes to say is that it works so well because the interests of the owners and the company are in total alignment, whereas with publicly held companies you have pension funds, small investors, day traders, unions, and so forth. Does that resonate with you?
Early on, I thought so. There may have been some cases where there was real alignment. But in recent years, I've become disenchanted with the whole concept. The goal with these people is a financial return. That's the only goal. And we have seen a number of cases where they have so over-leveraged the businesses they acquired that the businesses basically have failed because of the debt. These are some proud companies that have been around for a long time. If being private is such a great thing, why are the private equity firms themselves going public? Ⓑ

HE WAS REALLY FOCUSED, AND HE DIDN'T EXPECT HIS TOP MANAGEMENT GROUP TO BE LOOKING FOR WARM AND FUZZY THINGS

On Lou Gerstner

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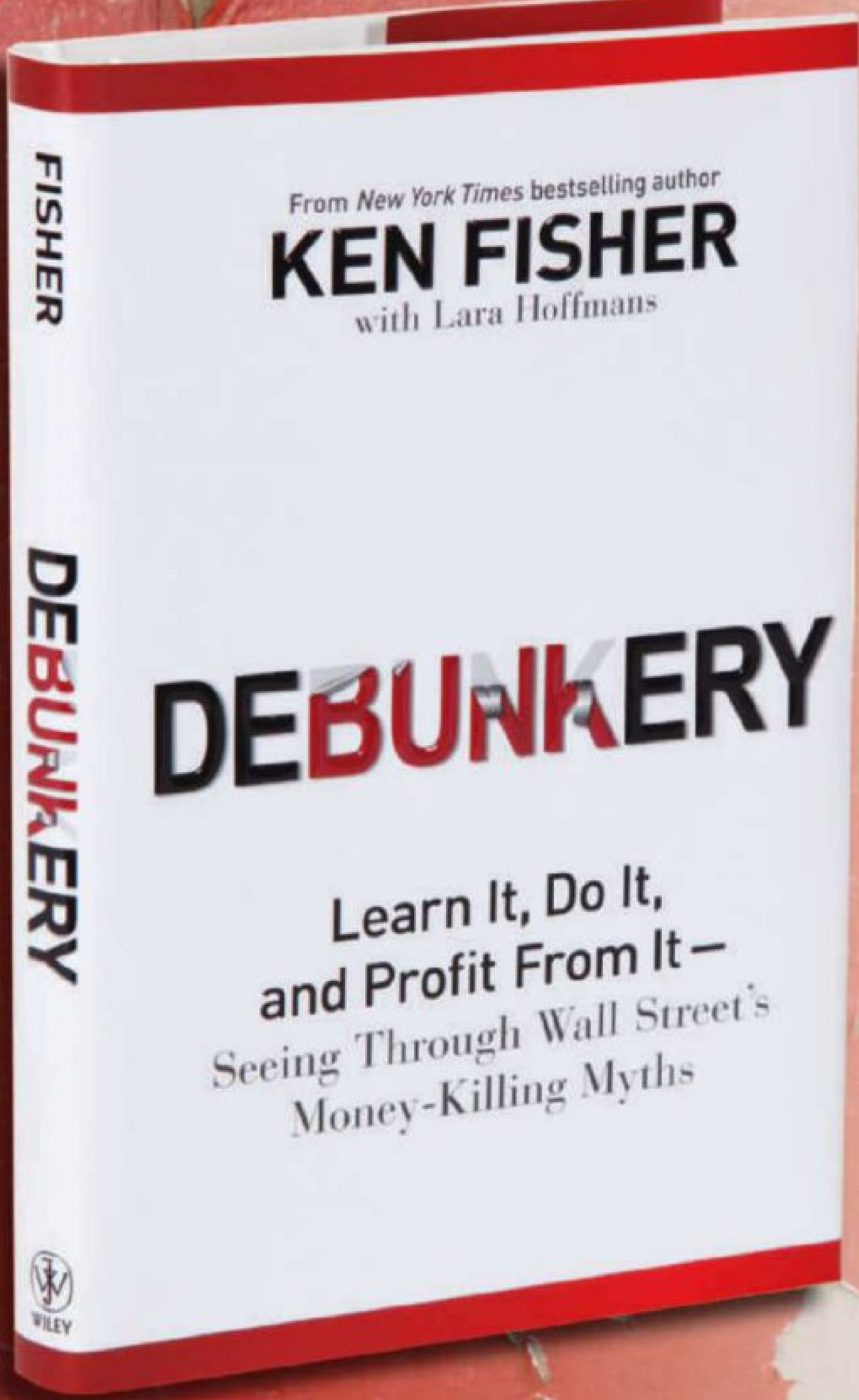
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The End of the Office Holiday Party

With fewer companies hosting bashes this year, the hallowed tradition of getting bombed with co-workers is under assault. *By Joel Stein*

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Etc. Holiday Parties

The cultural cognoscenti appraise their top gifts given, received, and desired



MOST WANTED GIFT: "I'd love for my friends and family to donate to the ASPCA so that the city's shelter dogs and cats aren't forgotten during the holidays." —**Dylan Lauren** *CEO, Dylan's Candy Bar*

Royal families aren't necessarily known for their sensitivity to the economic plight of their subjects. Yet Queen Elizabeth II announced last month that she was canceling Buckingham Palace's biannual Christmas party. It would have seemed insensitive, given the deep cuts in social services now raining down on Britain, to spend $80,000 on a soiree in which 600 commoners are allowed to get wasted alongside royalty. When the Queen is calling off her Christmas party, it's a bad sign for everyone else.

The last few years have already been ugly for the holiday party. This December, only 79 percent of companies will throw one, according to international executive search firm Amrop Battalia Winston. It's the lowest number in the three decades that the company has conducted its poll. The figure is also down 2 percent from last year and 16 percent from 2002-04. Almost as bad, 27 percent of celebrating companies say their event will be more modest than last year's. Even the people who work at Playboy Enterprises are tightening their belts. The company–which used to hire a band, run a casino, and take over a nightclub–is holding a daytime get-together next month. Instead of being hosted by playmates at the Playboy Mansion, it will be held at the company's Los Angeles offices, with only normally dressed employees invited.

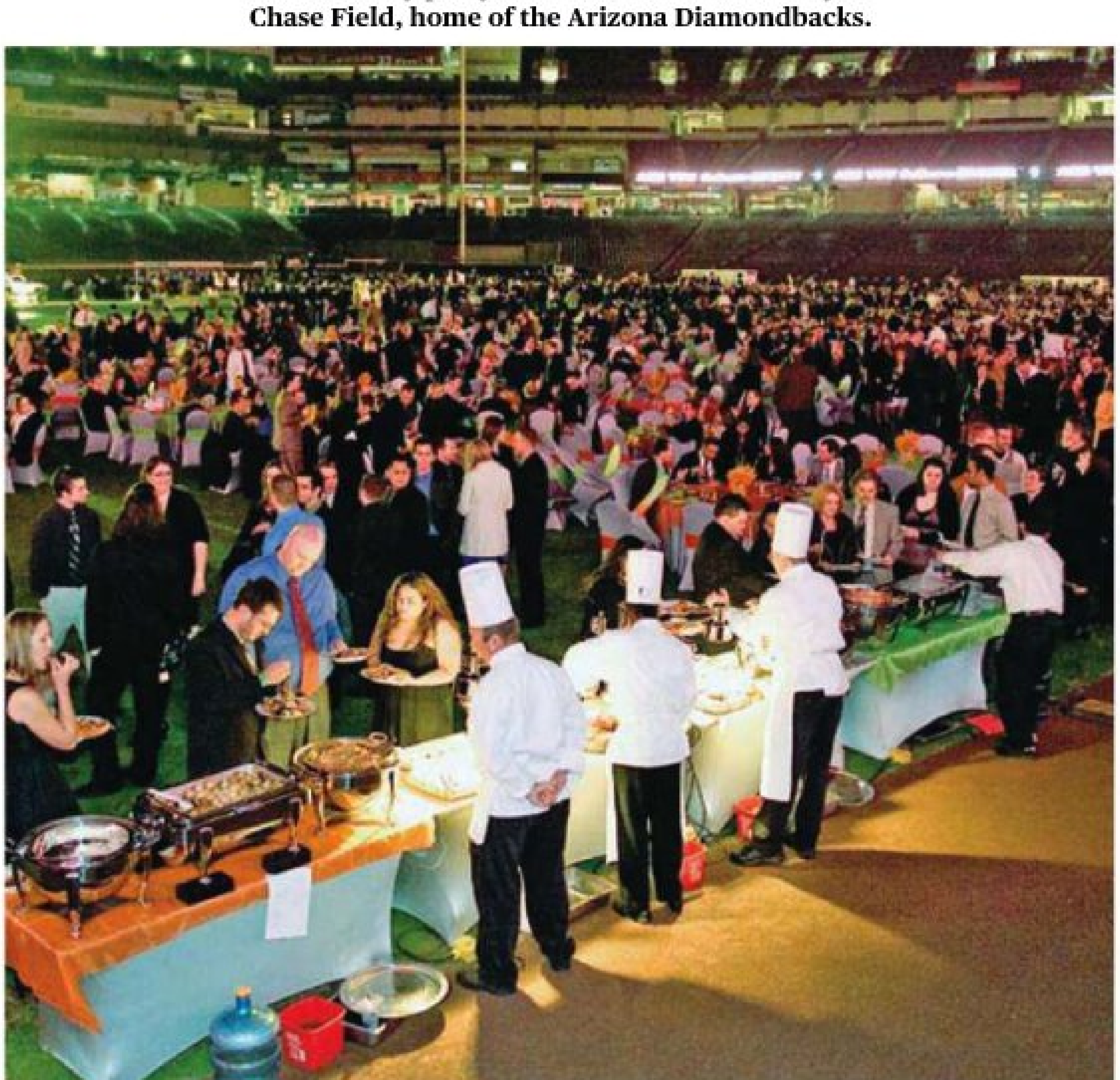
Even more disturbingly, Arlington (Va.)-based publishing company Bureau of National Affairs (BNA) claims that only 58 percent of company holiday parties will serve alcohol this year–down from an already startling 61 percent last year. In other words, some office parties are not parties at all. American Express OPEN Small Business Holiday Monitor, which conducts a similar poll, concluded that 69 percent of companies were throwing parties this season, while outplacement firm Challenger, Gray & Christmas is expected to publish an equally dire poll later this year. The only industry doing well enough for holiday parties may be the holiday survey business.

"I'll give away a million bucks," says Go Daddy's CEO of a holiday party tradition

The Queen canceled Buckingham Palace's Christmas party this year



Revelers chow down on the buffet line at Go Daddy's 2007 holiday party. The event is held annually at Chase Field, home of the Arizona Diamondbacks.



For companies hell-bent on showing some yuletide cheer, the decision to party like it's 2006 is full of downsides. "It's a fine line the employers walk," says Matthew Sottong, BNA's director of surveys and research. "It's hard to say, 'It's been hard times and maybe we had some layoffs, but let's have a party!' On the other hand, it's hard to say, 'After all this belt-tightening, we're not going to have a party!'" According to Amrop Battalia Winston Chairwoman and Chief Executive Officer Dale Winston, 50 percent of companies who are not having a party say they want to avoid "perception problems." The sensible approach is to make like the Queen and blame the lack of fun on people who are suffering.

For many employers, the most compelling reason to hold a party this year is simply to convince employees that they're not going out of business. ("It's one of the few barometers employees have as to how the company is doing," says Sottong.) After canceling its party for two years, Logic, a technology consulting firm based in Inver Grove Heights, Minn., has reinstated the event. The 144-person company is flying all its U.S. workers and their spouses into Minneapolis and hosting a dinner with an open bar and a $250 gift card as a party treat. "We want to show our appreciation," says Logic President Amber Naqvi, "and indicate that we are on solid financial footing,"

As bad as things may be, some companies are still throwing pre-bust-style blowouts–and they want everybody to know it. "There's that old saying that misery loves company," says Go Daddy CEO Bob Parsons. "Well, we decided not to join them." Last year the Internet domain registry company spent more than $3 million on its holiday party, the biggest ever thrown in Chase Field, home of the Arizona Diamondbacks. (The company paid extra to install an ice rink.) More than 6,000 people will come to the stadium again this year, including Go Daddy Girls race car driver Danica Patrick, personal trainer Jillian Michaels, singer Ella Koon, and poker player Vanessa Rousso. The party has become a key part of the company's recruiting pitch.

This year's event will be even bigger. "Brother, it is going to rock," says Parsons. "We're going to put last year's to shame." Parsons has hired three major bands to perform, and even though he's keeping their identities a secret until that night, he assures

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BEST GIFT EVER RECEIVED: "My first bicycle. It was a red Schwinn Sting-Ray with chrome fenders and a banana seat."
—**Chris McCormick** *President and CEO, L.L. Bean*



HOLIDAY WISH: "For people to support Seth Reams, who, while struggling to find work, started wevegottimetohelp.org."
—**Arianna Huffington** *Editor-in-Chief, Huffington Post*

his employees they are "the duck's nuts." There will be fireworks and the return of an annual ritual in which Parsons gives away massive amounts of cash at a raffle. "I'll give away a million bucks by pulling names out of a hat. And when I give money away, I pay the taxes on it," he says. "I don't want to be the richest guy in the graveyard." When throwing a party this good, spouses want to go. That cuts down on the chances of employees getting drunk and sleeping with each other. "Most of the guys bring their wives," Parsons says. "The single people–most of them will also bring somebody. So it's really not a hookup event."

It shouldn't be a surprise that many of the great remaining parties are given by Internet companies. Barry Diller's IAC still throws its bash in the giant lobby and courtyard of its Frank Gehry-designed Manhattan headquarters, which doubles as a high-end event space throughout the year. The party has about 1,000 guests and has included a photo booth, a deejay, and a beloved chocolate fountain. Yet even Internet companies are cutting back. The website College Humor used to invite monkeys to its annual party. After being bought by IAC, the simians were no longer welcome.

There is, however, one industry outside technology that's still feeling bold and rich: personal injury law. W. Mark Lanier, who runs the 45-attorney firm Lanier Law Firm, has booked Sting to play at his holiday party next month in Houston. Lanier expects 8,000 employees, clients, and friends to attend what could be an even better bash than his $650,000 party in 2004, when Bill Cosby warmed up the crowd for Al Green.

In Hollywood, most movie studios aren't closing off the lot anymore, but agencies still go all out during the holiday season. William Morris Endeavor's Los Angeles office is having 1,200 employees and their guests for dinner at The Bazaar, the only restaurant to get four stars from the *Los Angeles Times* in the last five years. (The chef, José Andrés, is a client.) In addition to foie gras wrapped in cotton candy, there will be a photo booth and movie karaoke, where employees must talk along with the scene's dialogue.

Even after the economy gets back to normal, it's likely that Christmas parties won't. Like liquor-soaked client lunches, the office holiday party may be a dying vestige of an earlier era. "Twenty years ago you had to decide which of your vendors' parties you'd have to go to," says Amrop Battalia Winston's Dale Winston. "It got to the point where people felt it was a chore. Consequently, why spend all that money obligating your clients to come to your party?" Perhaps when work became much more casual, you didn't need one day to let go. Or maybe when work is on your home computer and your cell phone, you don't want to spend your free time at an office. Or maybe people just don't know how to hold their liquor anymore. Ⓑ

Party Politics

Celebrity event planners Jes Gordon and Linnea Johansson and etiquette expert Diane Gottsman advise how to leave the party with your dignity, and your job, intact. —*Spencer Bailey*



AVOID OVERINDULGENCE

Eat, drink, and be merry–but don't let yourself become "that guy." As Gordon puts it, "Ride the pony throughout the night. But don't go to a gallop. Pace yourself with all behavior." Why? "You don't want to hear about the vomit stories on Monday."



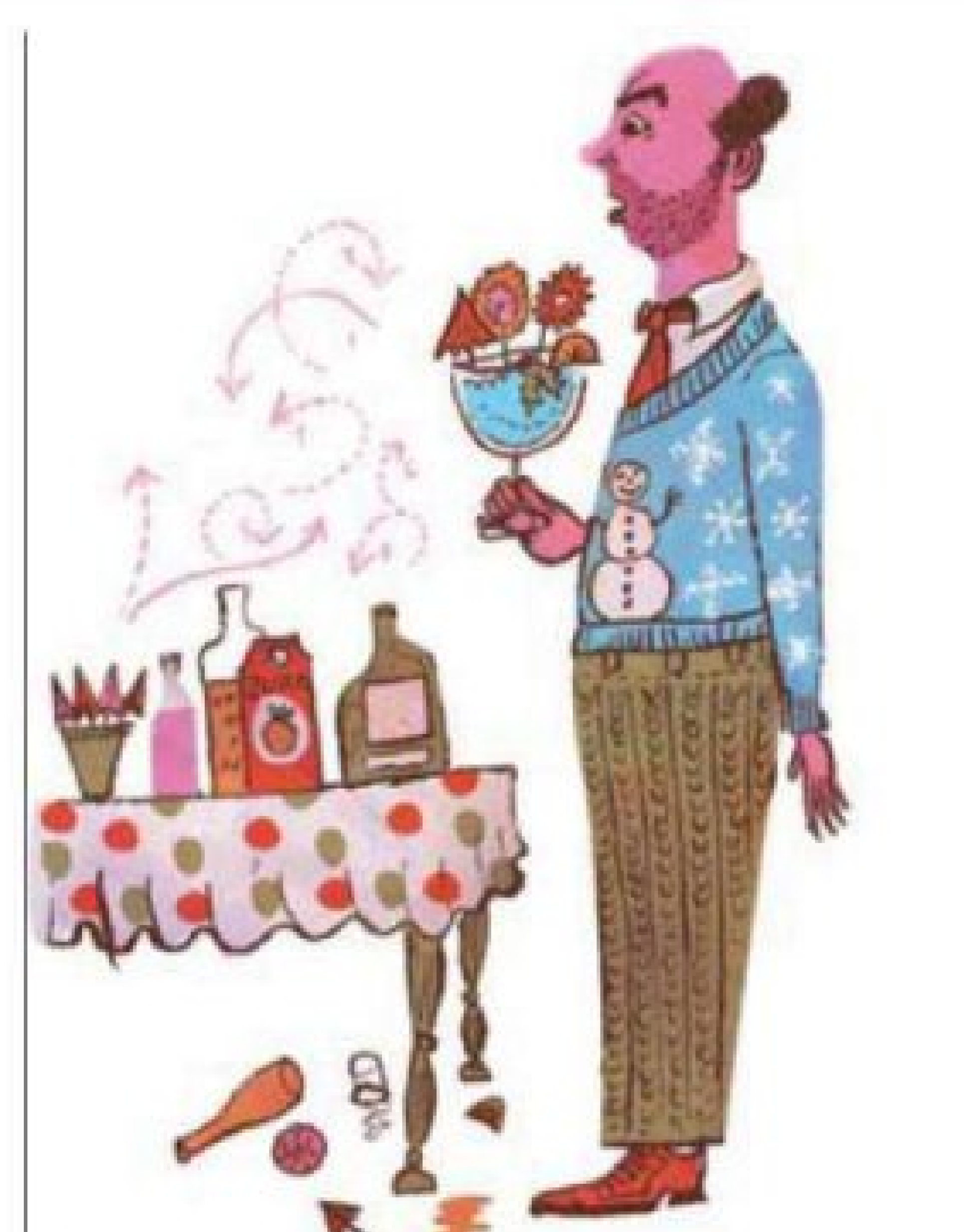
NO FLIRTING

Sidestep co-workers' come-ons. "No one wants to see the almost-retired VP kiss the intern under the mistletoe," says Johansson. Adds Gottsman: "Kissing under the mistletoe is a definite no. So are tying a cherry stem into a knot with your tongue and strip poker."



DITCH THE FESTIVE ATTIRE

Keep reindeer antlers and holiday sweaters at home. Opt for what Gordon calls "cocktail chic"–seasonal, but informal work attire. "The more skin you show, the less power you have," says Gottsman. "Avoid any micro-minis or plunging necklines."



SKIP COMPLICATED COCKTAILS

Avoid shots, liqueurs, and mixed drinks, and stick with wine, beer, and punch. This will ward off a quick buzz and decrease the chance of throwing up your lunch. "Plus," says Johansson, "it gets pretty social around the punch bowl."

THE SIMPLE HOLIDAY COCKTAIL: *Spiked Spiced Apple Cider*

1 part Xanté pear cognac
4 parts fresh apple cider
1 cinnamon stick

Heat apple cider and cinnamon stick. Add pear cognac. Serve hot or cold.

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Etc. Gift Guide



HOPES TO RECEIVE: "An Avenue B Ebony watch by Harry Winston."
—**Georgina Chapman** *Co-founder and designer, Marchesa*

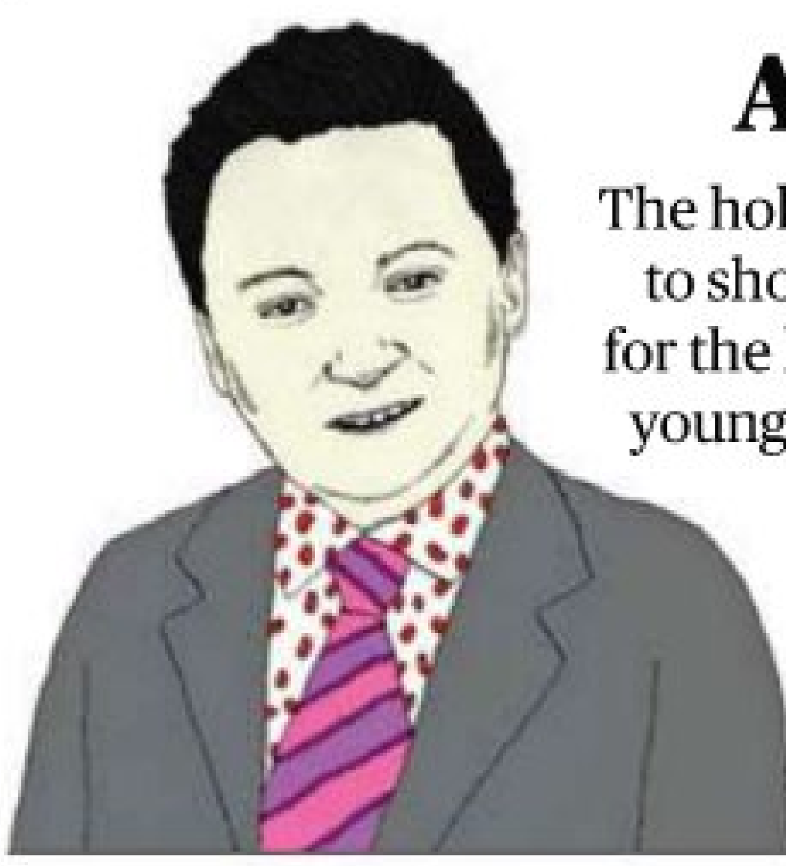
The Office Gift Matrix

What to get the people who matter at work—at every price



MODEST

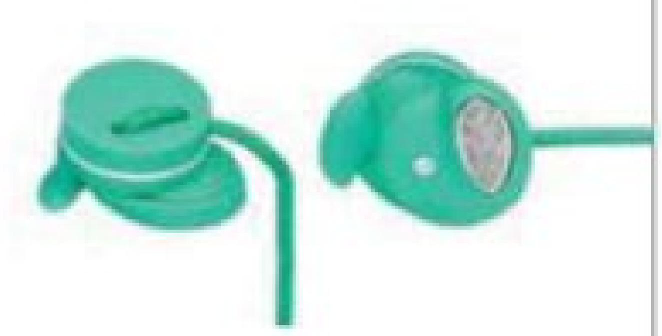
Assistant



The holidays aren't just a time to show your appreciation for the hip, culturally attuned young person who answers your phone and fetches your dry cleaning. They're also a chance to earn cool points.



Kings County Distillery moonshine
Price: $20
Unaged corn whiskey from New York's first distillery since Prohibition beats Champagne. *kingscountydistillery.com*

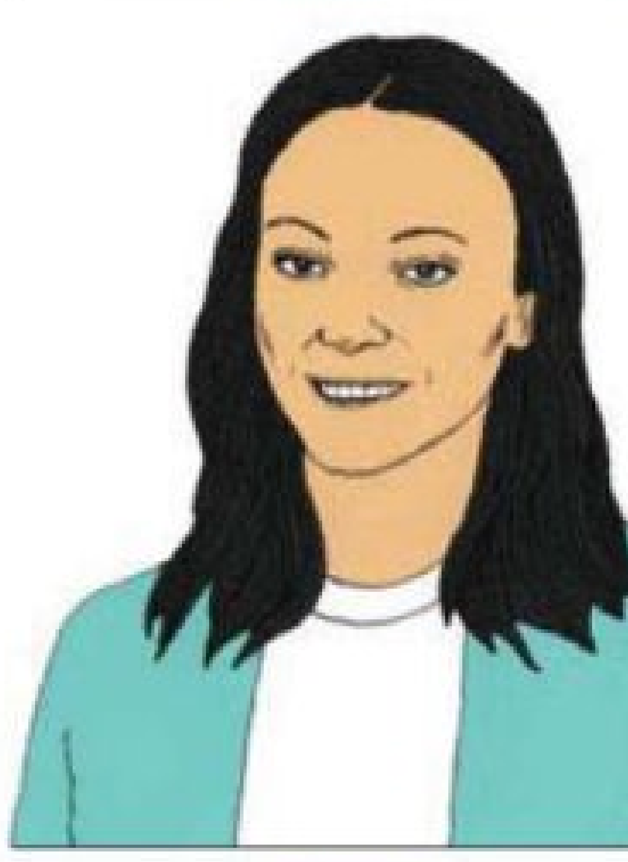


Urbanear headphones
Price: $50
A subtle way of saying, "Please stop playing *Chocolate Rain* with the volume on." *urbanears.com*



Wool and the Gang knitting kit
Price: $67 and up
You'll no longer feel bad about putting your assistant's desk beneath the AC. *woolandthegang.com*

Cubemate



When you sit shoulder-to-shoulder with your co-workers, you get to know everything about them—right down to their yoga schedule. Take his or her interests into account when choosing a gift.



Momofuku cookies
Price: $10 per tin
Chef David Chang's cookies are the new Magnolia Bakery cupcakes, but without the gratuitous *Sex and The City* references. *momofuku.com*

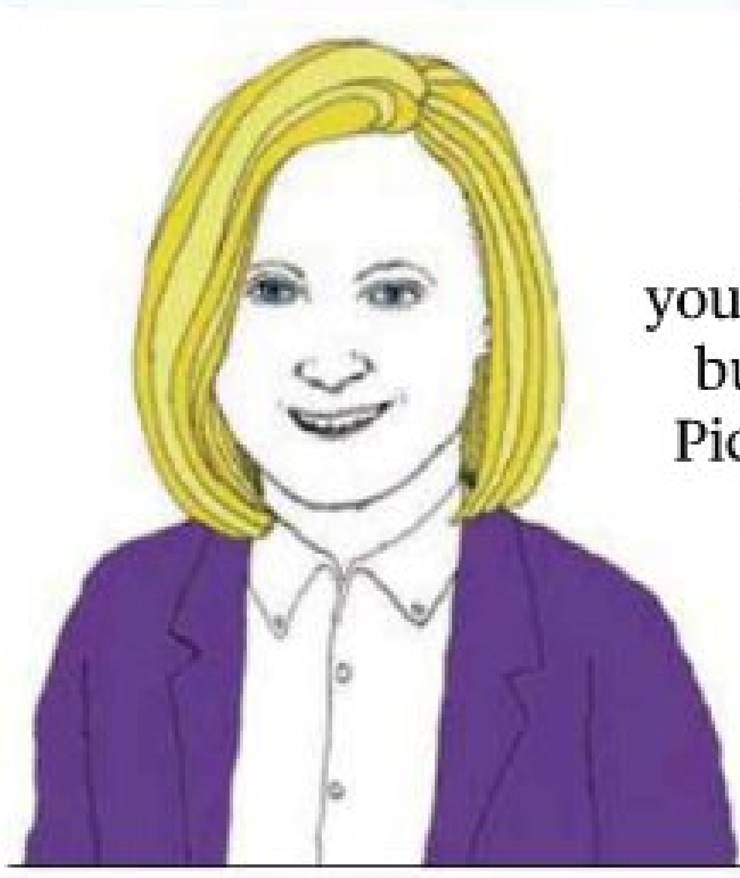


Mini Espresso Maker
Price: $39
You, too, can use this beverage brewer—which makes a great double shot—if your cubemate keeps it on his or her desk. *restorationhardware.com*



Lomography Fisheye No. 2 camera
Price: $70
This 170-degree wide-angle camera uses 35mm film (remember that?). *lomography.com*

Client



Presents given to your stable of clients help build business bonds. Pick your gifts carefully based on how long and how well you know your recipient. The right gift could make your sales year.



Golf Ball Personalizer
Price: $22
What better way to prove that you've been listening to your client brag about his handicap? *restorationhardware.com*

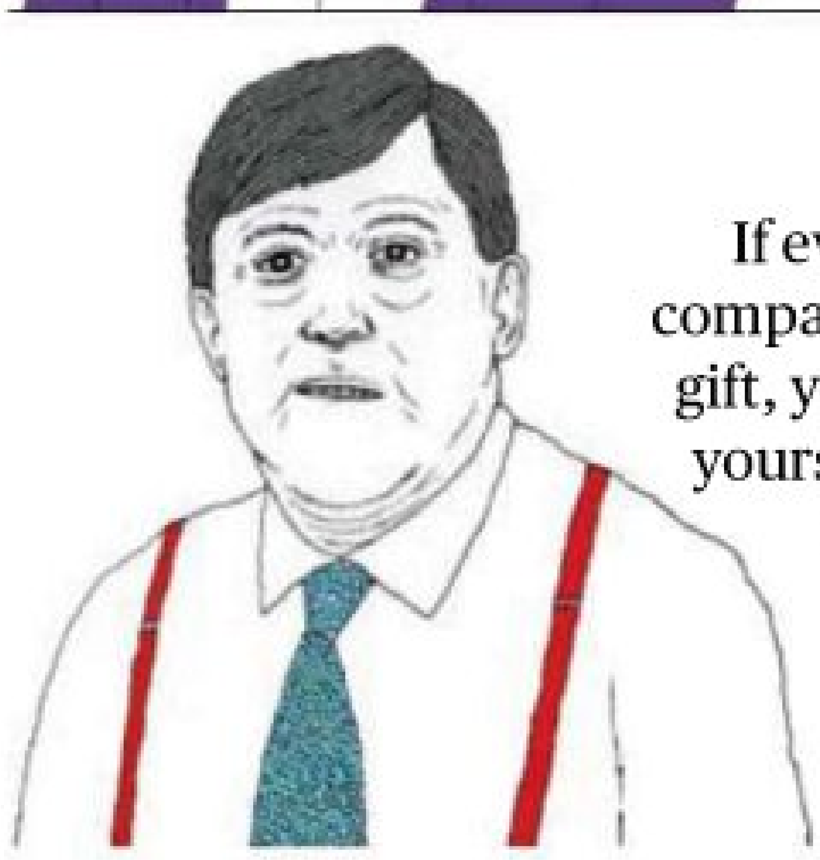


Vieux Carré absinthe
Price: $56
No liquor cabinet is complete without a bottle of the first legal absinthe to be made in the U.S. in nearly 100 years. *vieuxcarreabsinthe.com*

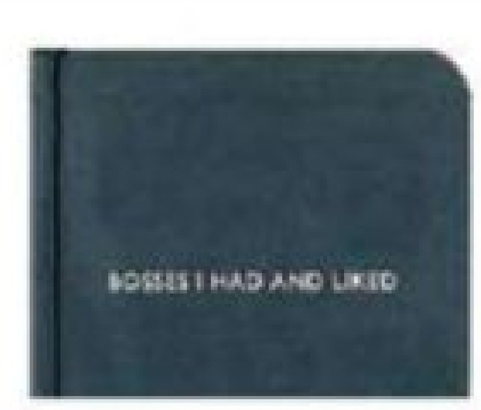


Cire Trudon candle
Price: $75
Don't just default to Dipt yque or Jo Malone. Instead, give a candle from the world's oldest candle maker. *ciretrudon.com*

Boss



If everyone at your company gives the boss a gift, you've got to make yours really count. Think outside the box to avoid any chance of duplication. It's an investment in your future.



Bosses I Had and Liked notebook
Price: $14
Score brownie points with this Archie Grand memo pad, which fits in a suit pocket or clutch. *archiegrand.com*



Mini World Time Alarm Clock
Price: $55
The time changes when you switch the bezel to match your location. *restorationhardware.com*



Ace Walking Stick
Price: $78
This natural wood walking stick is handmade by the chic Ace Hotel and Swim Club in California. *communedesign.com*

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BEST GIFT EVER GIVEN: "A second chance to an employee who made the most of it." —Joe Plumeri *Chairman and CEO, Willis Group Holdings*



BEST GIFT EVER RECEIVED: "Many years ago, my parents gave me a full set of Georg Jensen antique flatware." —Laura Alber *CEO, Williams-Sonoma*

$100 | **$150** | **$200** | **$300** | **$400+**

EXCESSIVE



Woolly Pocket Meadow
Price: $92
A planter pouch will spruce up your hippie assistant's cube. *woollypocket.com*



Kinect for Xbox 360
Price: $150
Reward a hard worker with Microsoft's controller-free answer to the Wii. *xbox.com/en-US/kinect*



Graphic Image leather thesaurus
Price: $165
A monogrammed thesaurus is perfect for someone whose vocabulary consists of "OMG" and "WTF." *graphicimage.com*



Duckie Brown shoes
Price: $295
Improve your assistant's Zuckerbergian wardrobe with these straight tip shoes, available in four colors. *florsheim.com*



South by Southwest Platinum badge
Price: $1,050
The badge offers access to all the concerts and films at Austin's famous music festival. *sxsw.com*



Quality Mending Co. large tote bag
Price: $98
This bag will make them the envy of their colleagues and gym mates. *thequalitymendingco.com*



WeWood watch
Price: $119
For every watch purchased, the American Forests conservation nonprofit will plant a tree. *we-wood.us*



Jawbone Jambox portable speaker
Price: $199
This small wireless speaker transforms into a speakerphone for conference calls. *jawbone.com*



Lulu Frost necklace
Price: $285
Nothing says "I totally have a work crush on you" like this Lulu Frost Mesh Center Drape necklace. *lulufrost.com*



Montante for Maserati 8CTF bike
Price: $4,108
Upgrade commuting wheels with this Cicli Montante bike, modeled after an eight-cylinder 8CTF race car. *montantecicli.it*



Solio Classic Solar Charger
Price: $100
Greenies, geeks, and even normal people can appreciate a charger that doesn't connect to the wall. *rei.com*



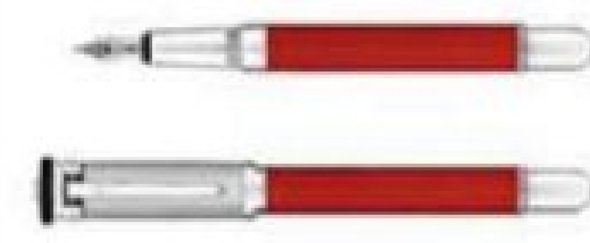
One-year Hulu Plus subscription
Price: $119
Current season episodes from 45 TV shows can be streamed on computers, iPhones, iPads, or TV sets. *hulu.com/plus*



Adopt a Water Buffalo
Price: $250
Adopting one through Heifer International will help a Filipino family plant food and haul it to market. *heifer.org*



Tumi for Opening Ceremony travel bag
Price: $295
Every fashionable road warrior can use this multicolored tote made out of indestructible nylon. *openingceremony.us*



Dunhill Sentryman Explorer pen
Price: $5,000
This pen starts fires: Flint in the barrel creates a spark when struck against the magnesium around the cap. *dunhill.com*



Hooker's Delight martini olive hook
Price: $84
With the three-martini lunch on the resurgence, top off his or her glass with an olive hook. *greeceisforlovers.com*



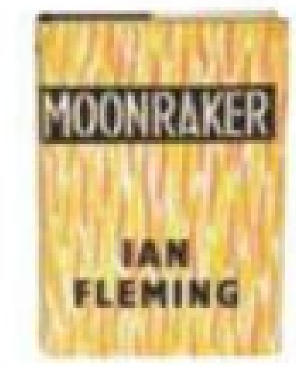
One-to-One Mac training
Price: $99
Hire an instructor to teach your boss how to use the 998 apps on his iPhone or stream files on her Mac. *apple.com*



Bulgari money clip
Price: $240
A sterling silver money clip in the shape of a paper clip is a clever alternative to a bulky wallet. *bulgari.com*



Colorware iPad case
Price: $300
Differentiate an iPad with this protective carrying case. Colorware also colorizes iPhones, computers, and headphones. *colorwarepc.com*



First edition book
Price: $645 and up
British luxury purveyor Asprey can track down even the rarest first editions. *asprey.com*

—Erica Blumenthal, Adrienne Gaffney, Rich Jaroslovsky, Nadine Jolie, and Adam Klappholz

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BEST GIFT EVER RECEIVED: "A painting by Frank Stella, from Frank Stella" —**Richard Meier**
Managing Partner, Richard Meier & Partners Architects



Starbucks' "holiday beverage platform" sold 30 percent more drinks last holiday season than in 2008-09

'Tis the Latte Season

Holiday coffee drink mania is going to be bigger than ever this year. *By Benjamin Wallace*

In the retailing precincts of Big Coffee, seasonal flavors like peppermint and pumpkin swirl together every winter into a blizzard of high-calorie, lily-gilding espresso drinks—and it works like a charm. Starbucks officially rolled out its so-called holiday beverage platform on Nov. 16 with great expectations. Such drinks, which cost more than double the price of a regular "tall" cup of joe, accounted for 10 percent of all hot beverages sold during last year's holiday season.

Too much is never enough when it comes to holiday coffee drinks. In addition to top-seller Peppermint Mocha Latte and powerhouses Gingerbread Latte and Eggnog Latte, which made its debut in 1985, this year Starbucks is testing a 100-calorie "skinny peppermint mocha" in California and four Southern states. Dunkin' Donuts, which got into the holiday drinks game mid-decade, is launching a less caloric gingerbread-flavored drip coffee.

The holiday drinks arms race has now descended to regional brands and supermarkets—and what once seemed like a frivolous fad has become a thriving sub-industry. Caribou Coffee, a Minneapolis-based retailer, offers Fa La Latte and Ho Ho Mint Mocha. Maxwell House offers a Peppermint Mocha Latte mix, and Coffee-mate creamer sells flavors such as Eggnog Latte and Gingerbread Latte. Even Jittery Abe's, a café aboard the naval carrier *USS Abraham Lincoln*, parked off the coast of Pakistan, serves the Starbucks seasonal flavors during the holidays.

This isn't a surprise, given Starbucks' growing holiday success. Last season it sold 30 percent more seasonal drinks than the year before, according to Julie Felss Masino, Starbucks' global beverage vice-president. "The consumer has been in this comfort mood for a long time," echoes Stan Frankenthaler, executive chef at Dunkin' Brands. "We keep growing our offerings for this time of year."

Still, the recipe for success can be complicated—particularly for gingerbread. Starbucks had a New Coke moment a few years ago when it altered its Gingerbread Latte recipe. "Customers didn't like it," Masino says. "We heard, 'Bring back our favorite,' so we did." In 2006, Dunkin' Donuts added a gingerbread latte, but only after experimenting with between 6 and 12 variations, from "mustardy" to "spice cake." After customer taste tests, it chose one. "That's the exciting stuff for us," Frankenthaler says. "We're like, 'You like that? All right, let's dial up more nutmeg!'"



THE ANNALS OF HOLIDAY ESPRESSO BEVERAGES

↓

1985
Starbucks offers its first eggnog latte drink



↓

1999
Starbucks rolls out its gingerbread latte



↓

2004
Dunkin' Donuts offers its first holiday drinks, including a white chocolate raspberry latte

↓

2006
Dunkin' Donuts introduces a competing gingerbread latte

↓

2010
Starbucks tests a 100-calorie (for a "tall") skinny peppermint mocha

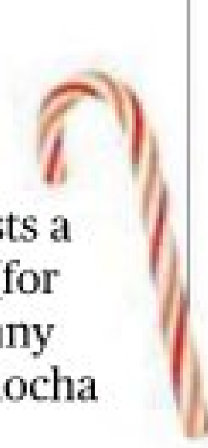


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DREAMS OF RECEIVING: "Bobby Flay to cook my Thanksgiving, Guy Fieri to bartend, and Sunny Anderson to deejay." —**Susie Fogelson**
SVP for marketing, Food Network and Cooking Channel



Al Thompson's home beat out New York's Fifth Avenue as one of the best places to tap into the holiday spirit

The Best and the Brightest

Richmond, Va., has become the center of the garish-home-lighting universe. *By Eric Spitznagel*

Few feel the weight of the holiday season like Al Thompson. Every year since 1999, Thompson, 64, has covered the exterior of his suburban home, just outside Richmond, Va., with approximately 170,000 lights, as well as 500 Christmas-themed figures—all built from scratch. The process, which begins after Labor Day, takes 400 hours. His electrical bill for December 2009 was $1,128.23.

For Thompson, this is merely the price of a job well done. In the past decade, his home has attracted tens of thousands of light-show groupies from across America and more than 65 foreign countries. "We have regulars now," he says. In 2007, Thompson beat out New York City's Fifth Avenue in *USA Today*'s "10 great places to plug into the Christmas spirit." More important, last year he won the coveted Most Likely To Be Seen From Space award from Tacky Light Tour, a Christmas-light enthusiast website. "There's a lot of pressure to perform," Thompson says with a sigh. "People have pretty big expectations."

"If you gave me half a million dollars, I'll give you a lighting design that will rock your socks off."

More than 80 million homes in the U.S. are publicly decorated for Christmas every year, according to light manufacturer Minami International. And thanks in part to Thompson, Richmond has become the capital of the lighting universe. In 1986 local DJ Barry "Mad Dog" Gottlieb hosted an informal bus tour of Richmond's excessively decorated homes during the Christmas season. Tour guests were fed beer and cookies and encouraged to nominate their favorite houses for a variety of awards, including "Mass Quantity," "Overall Wattage," "Acid Flashback," and the coveted "Holy S---! Factor." Within a few years, the holiday cheer had turned into a fierce competition among residents. "People would be very upset if their houses weren't picked," Gottlieb says. "I thought, 'We're going to start a war here if we're not careful!'" Although Gottlieb retired his tour after a few years, it spawned dozens of Tacky Light Tour imitators. Some compa-

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WORST GIFT EVER RECEIVED: "My dad thought my apartment needed a cat." —**Stacey Bendet**
Co-founder and designer, Alice + Olivia



BEST GIFT EVER RECEIVED: "A New York Giants helmet by [artist] Nathan Sawaya, made to scale, out of Legos." —**Jonathan Tisch**
Chairman and CEO, Loews Hotels; Treasurer, New York Giants

nies, like Winn Bus Tours, now charge up to $550 for a four-hour guided tour of the city's many lighted attractions.

In 2004, Matt Burgess launched The Tacky Lights Tour website as an interactive resource for visitors looking to lead their own Christmas tours of Richmond. As the site's popularity grew, Burgess expanded it to include photos, addresses, and driving directions to garishly decorated houses in 167 cities in the U.S., Australia, Canada, Denmark, and the U.K. "It seems to be growing organically each year," says Burgess. There's only one qualification for a house to be featured on the site. It must have no less than 10,000 Christmas lights on display. "My Web traffic has doubled every year," says Burgess. "And so has the number of lights."

Not everyone has the time or inclination to personally cover their home with 10,000-plus lights. That's why there are professionals. Josh Barnett, the founder and president of the Bakersfield (Calif.)-based Lightasmic!, works primarily with local governments and theme parks but also offers his services to homeowners, especially if their lighting needs are "extreme." A Lightasmic! production can cost anywhere from $20,000 to more than $100,000, depending on the client's demands. "As Christmas lights become more advanced, clients are looking for the next 'wow'—both technically and artistically," says Barnett. "If you gave me half a million dollars, I'll give you a lighting design that will rock your socks off."

While the number of lights matters, how you use them is just as important. Alek Komarnitsky, an engineer living outside Boulder, Colo., rarely decorates his home with more than 20,000 lights, but he beams the images each year from a trio of thousand-dollar webcams on his property to 500,000 adoring Internet visitors in 157 different countries. Since 2005, Internet viewers have been able to break down the fourth wall of holiday lighting by controlling the appearance of Komarnitsky's house from their desktops using X10 powerline technology. ("It has issues," he says of the equipment, "but I don't need millisecond response times and 99.999 percent accuracy.") In a glimpse of the Christmas lighting future, viewers can inflate and deflate large renditions of Frosty, Santa, and Homer Simpson from their desktops. "It can sometimes be a battle for control," he says.

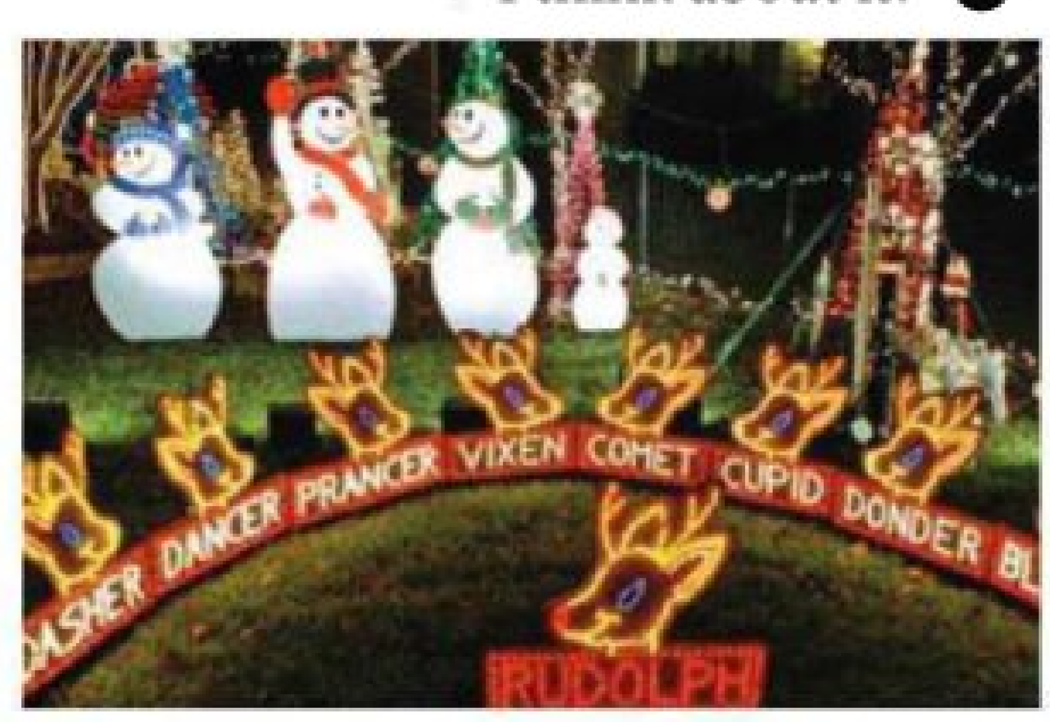
For people who take their holiday lighting displays seriously, websites such as Tacky Christmas Yards and Ugly Christmas Lights—which poke gentle fun at homes decorated with all the subtlety of a Dubai hotel lobby—pose a serious threat. Kat Shumar, who started Tacky Christmas Yards in 2007, gets photo contributions of illuminated homes from around the country and categorizes them on his site

One lighting enthusiast beams images of his home to 500,000 Web visitors in 157 countries

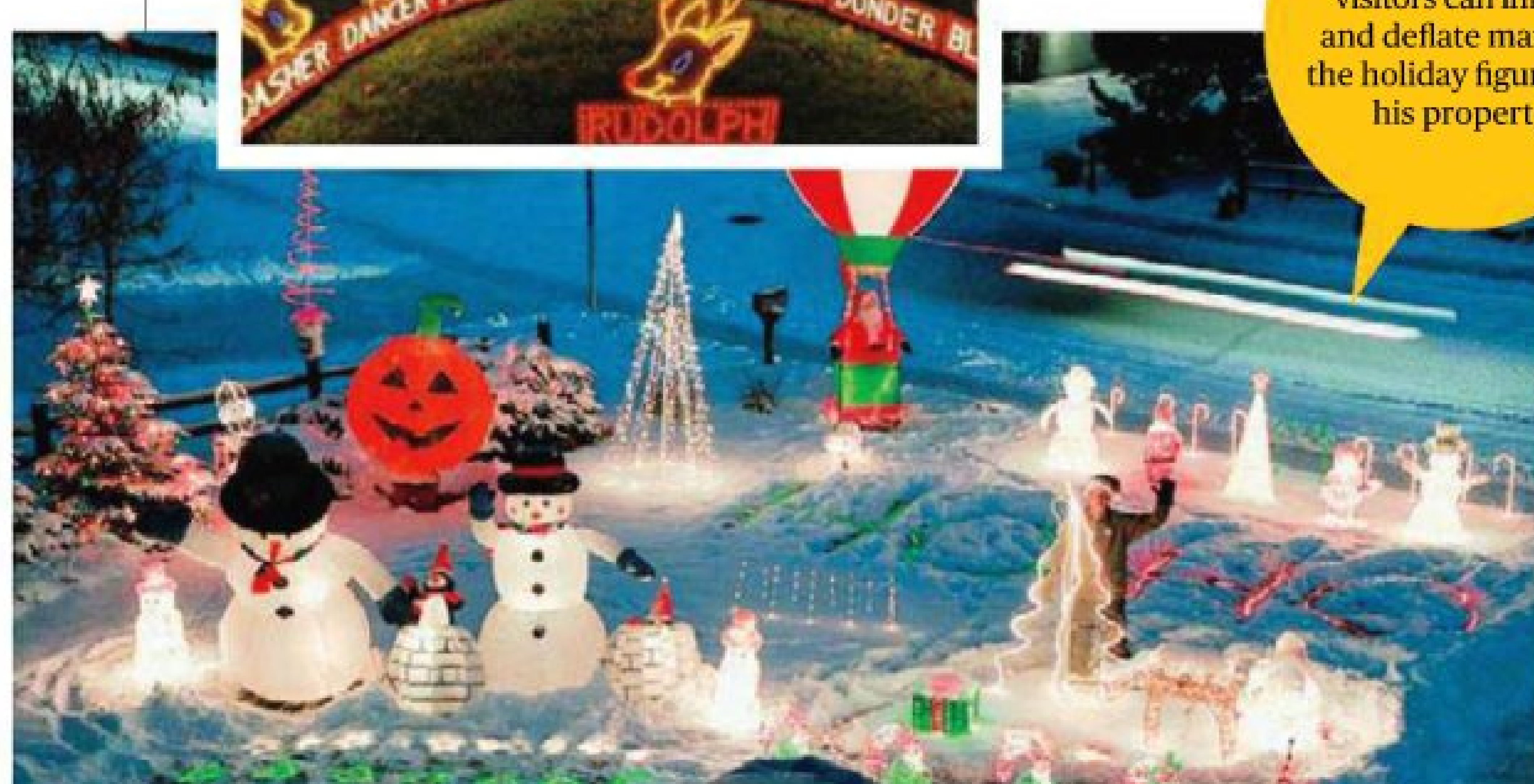
by "violation," such as "Unharmonious Arrangement," "Seizur-ific," and "Frequent Lighter Card." According to Shumar: "People turn in their photos and allow me to say what everyone is thinking."

Perhaps not what *everyone's* thinking. The Ugly Christmas Lights site, launched in 2002 by Matt Phillips, has received plenty of disturbing e-mails over the years—including one that compared him, inexplicably, to Osama bin Laden. "Christmas lights can be a sensitive subject," says Phillips. He insists he's not mocking the holiday, but "just people's lack of decorating skills."

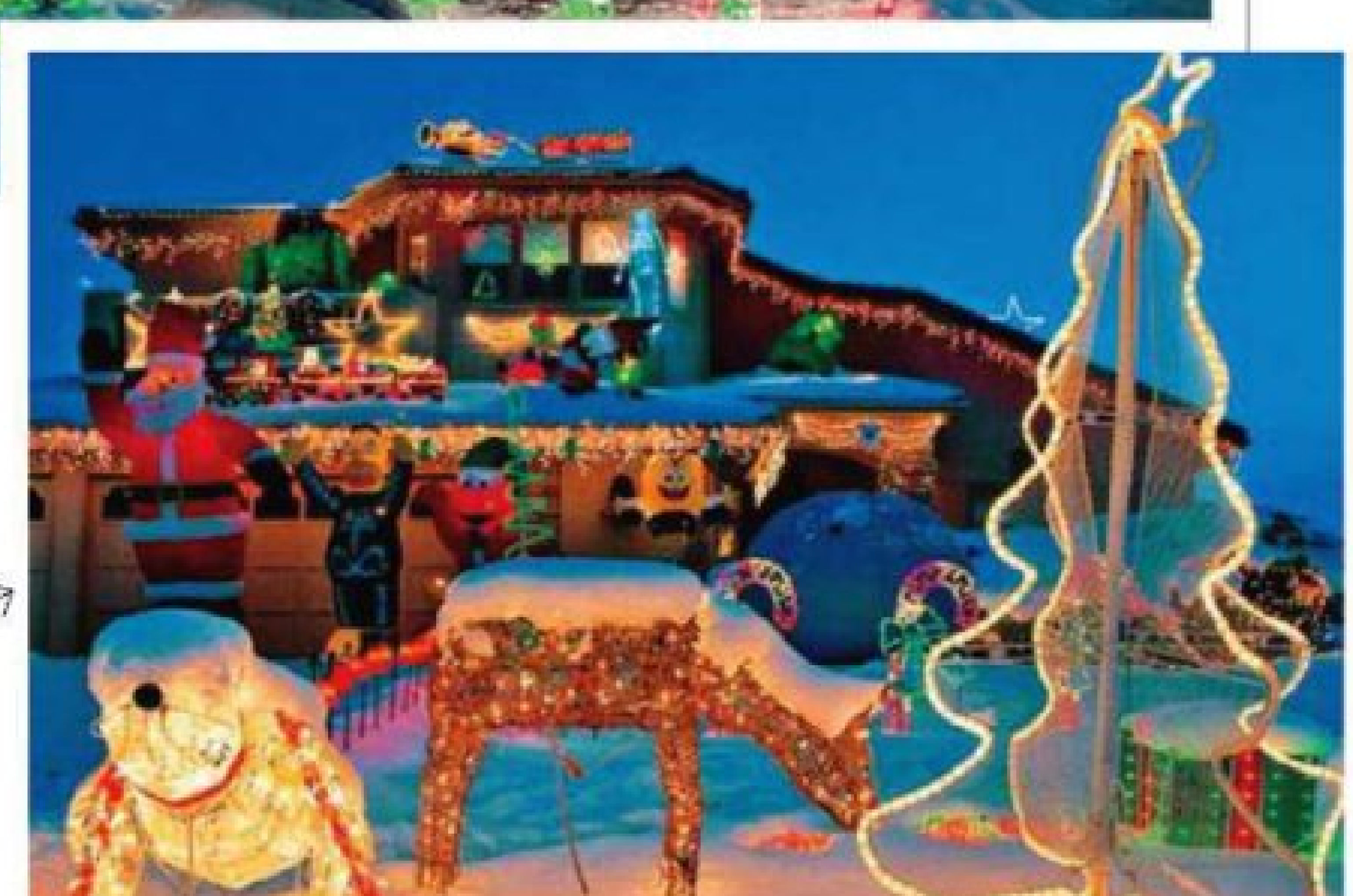
As divisive as Christmas lights can sometimes be, they also bring people together. Al Thompson remembers a Russian couple who traveled from Moscow on Christmas Eve 2008 just to see his light show. Thompson and his new friends reminisced about their childhoods, during which they were both warned to fear the other's respective country. Only at that moment, united by their shared appreciation for holiday excess, did they understand just how misplaced their paranoia really was. Says Thompson: "I still get goosebumps whenever I think about it." **B**



All of Thompson's 500 Christmas figures are built by hand



Komarnitsky's Web visitors can inflate and deflate many of the holiday figures on his property



Komarnitsky limits his display to 20,000 lights

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BEST GIFT GIVEN: "This year we gave $100 million toward the building of a new University of California at San Francisco children's hospital." —Marc Benioff *CEO, Salesforce.com*



Etc. One True Thing



The Secret Santa Gift

Score points with your colleagues—without spending more than $20. *By Jessica Flint*

The Want: A cheap, whimsical gift you can bestow on your assigned cubemate. It should be something that stays on your co-worker's desk all year. Bonus points if you can get some use out of it, too.

The Get: Desktop Ping Pong ($12 at fredflare.com). Table tennis has evolved from a suburban basement pastime to become the new poker—that is, a demi-sport in which adults can participate without embarrassment. The net's suction cups stick firmly to any surface, ensuring the net will stay put even against the hardest hitter. The paddles fit in your palms so you can imitate that Chinese penhold grip you vaguely remember from past Olympic champs. Ⓑ

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Inexpensive gifts for your somewhat persnickety co-workers:



The Neat Freak

Your obsessive-compulsive colleagues can keep their cube clean with this Mini Robo Vacuum. *$20 at fredflare.com*



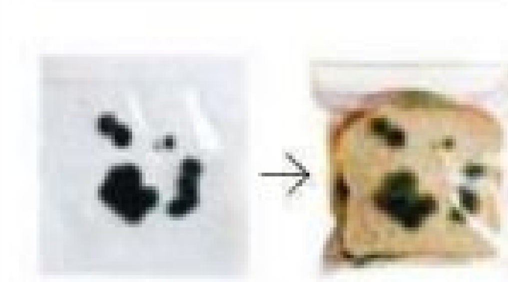
The TCM Junkie

Indulge a Bogie-loving co-worker with Cup of Fame—tea bags that feature Hollywood stars of yore. *$12 at colette.fr*



Happy-Hour Maven

The Disposable Flask makes drinking on the job a little easier. *$15 for set of three at restorationhardware.com*



The Foodie

Your pal's panini won't look as tempting in these green-stained Anti-Theft Lunch Bags. *$8 at thinkofthe.com*

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According to Taibbi, Greenspan, Blankfein, Palin, and Paulson are members of the "grifter class"



Interview with A Vampire Squid

Matt Taibbi blames the economy's failure on a new class of grifters

By Sheelah Kolhatkar

There was a time when former Federal Reserve Board Chairman Alan Greenspan—an economist, former jazz musician, and Ayn Rand devotee—was credited with fostering one of the longest economic booms in memory. Recent history, however, hasn't been so kind. According to Matt Taibbi, Greenspan is a mere "gerbilish mirror-gazer who flattered and bulls-----d his way up the Matterhorn of American power and then, once he got to the top, feverishly jacked himself off to the attention of Wall Street for 20 consecutive years." The author who once referred to Goldman Sachs in *Rolling Stone* as a "vampire squid wrapped around the face of humanity" has, perhaps unsurprisingly, declared Greenspan "The Biggest A------ in the Universe."

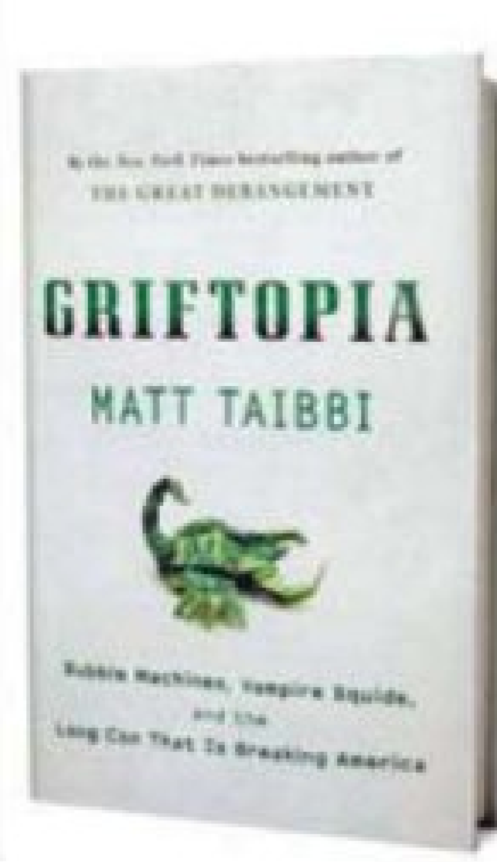
Such elegant phraseology is a trademark of Taibbi, who sits at the confluence of two trends sweeping the modern intellectual marketplace: say-whatever-the-hell-you-want-journalism and crisis-as-career-minting upward mobility. One of dozens of journalists and bloggers who scrambled to reinvent themselves as experts on Wall Street just as it became fashionable, Taibbi concedes that before Lehman fell, "Like most Americans, I [didn't] know a damn thing about high finance." In spite of that—or perhaps because of it—he's gathered a cult following. His new book, *Griftopia*, blames our financial mess on an oligarchy of grifters of all political stripes, from Greenspan and Sarah Palin to Hank Paulson and pretty much every single member of Congress. He doesn't produce any mind-blowing revelations about why the economy is so screwed up—or offer suggestions for how to fix it—but as a channel for unadulterated class rage, Taibbi can be quite effective. If anyone on your holiday list needs to up his or her righteous anger quotient beyond Paul Krugmanesque limits, *Griftopia* may prove the perfect stocking stuffer.

Few targets, regardless of their political persuasion, escape Taibbi's poisoned darts. Pundit Rick Santelli is "a shameless TV douchewad" credited with jump-starting the Tea Party movement through

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Griftopia: Bubble Machines, Vampire Squids, and the Long Con That Is Breaking America

By Matt Taibbi
SPIEGEL & GRAU; 272pp, $26



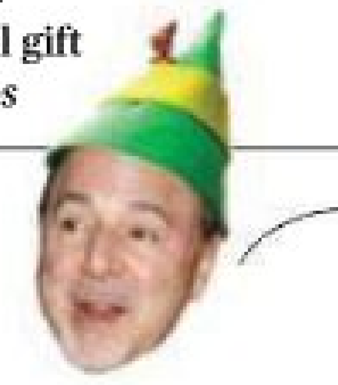
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BEST GIFT EVER GIVEN: "Every Zappos employee was given a Kindle or gift card last year. … This was a personal gift from myself and the CFO." —**Tony Hsieh** *CEO, Zappos*



BEST GIFT EVER RECEIVED: "A 1961 Corvette from Bruce Springsteen." —**Tommy Mottola** *Former chairman of Sony Music and co-owner of Casablanca Records*

his February 2009 tantrum on CNBC—itself "a propaganda organ for rapacious Wall Street banks." The mortgage industry is little more than "some sort of pseudo-criminal scam." Commodities speculation is, to Taibbi, "a scam of almost breathtaking beauty," while the health-care reform bill was a "grotesque giveaway" to insurance companies. Taibbi describes Goldman as a company of "criminals" and Washington—the capital of "puke politics"—as a land where elected officials pimp themselves out in exchange for campaign donations.

Taibbi has the right to be angry, and many of his targets are legitimate. With a few exceptions, the perpetrators of the financial crisis have escaped more or less unscathed, while most everyone else is still stumbling along, feeling poor and anxious. The worse things get for average Americans, the better off the top 1 percent—the backbone of the "grifter class"—appears to be; in 2007 they absorbed 23.5 percent of the country's pretax income, according to the Institute for Policy Studies. However, all the bluster and machismo with which this information is delivered can grow wearying. There are only so many uses of the word "balls" a girl can tolerate.

Griftopia is at its best when Taibbi moves away from quoting *Futures Industry* magazine and fuses his economic apoplexy with his main pre-meltdown area of expertise: politics. In one chapter he details the way the Tea Party and its leaders, such as Palin and Representative Michele Bachmann (R-Minn.), have cynically mixed race politics with class warfare, to devastating effect. Through Palin's folksy, underdog rhetoric, the Partiers have managed to convince large numbers of people that total deregulation and closing down the Federal Reserve are prudent responses to the crisis and recession. "Getting ordinary Americans to emotionally identify … with the political wishes of their bankers and credit-card lenders and mortgagers is no small feat," Taibbi writes. "A loose definition of the Tea Party might be 15 million pissed-off white people sent chasing after Mexicans on Medicaid by the small handful of banks and investment companies who advertise on Fox and CNBC." As in other instances, beneath the hyperbole, Taibbi might have a point.

The Tea Party itself has proven that there is something to be said for unfiltered anger. And Goldman Sachs will be trying to live down its comparison to a cephalopod for a long time. As Chief Executive Officer Lloyd Blankfein observes in a blurb on the back cover of *Griftopia*: "Oddly enough, the *Rolling Stone* article tapped into something." That may be particularly bad news for Alan Greenspan. But it's very good news for Matt Taibbi. B

The Business Book Crib Sheet

Haven't digested the year's top business books? Your punch-bowl conversation partner will never realize as long as you deploy these knowing, cocktail-ready rhetorical nuggets. —*James Pressley*



***The Big Short* by Michael Lewis**
"Lewis unearths those who shorted the subprime market—particularly one loner with Asperger's. Who else would wade through hundreds of mortgage bond prospectuses?"

***All the Devils Are Here* by Bethany McLean and Joe Nocera**
"Better timed for the *next* financial crisis, the reporters detail Fannie Mae's mad plunge into the subprime swamp."

***American Colossus* by H.W. Brands**
"This narrative history shows how a capitalist revolution made the long march across America after the Civil War. Brands rattles off examples of how the free market dragged the South out of its feudal past."

***More Money Than God* by Sebastian Mallaby**
"Hedge fund moguls have an image problem. In this history of the investment fund, it's easy to understand why: Its annals are rife with messianic complexes and sadomasochistic tendencies. However, Mallaby argues hedgehogs represent a promising, if partial, alternative to the banking supermarkets that blew up in the financial crisis."

***The Hellhound of Wall Street* by Michael Perino**
"In 1933 former New York prosecutor Ferdinand Pecora was hounding a prominent banker, 'Sunshine Charlie' Mitchell, in Senate hearings. The investigation led to the first federal securities laws and the inception of the SEC."

***On the Brink* by Henry M. Paulson Jr.**
"Should we buy his argument on why the government let Lehman collapse? Nah."

***The Quants* by Scott Patterson**
"Though math-geek arrogance drips off the pages, don't mistake these guys for *The Big Bang Theory*'s Sheldon Cooper. The arcane models of these quantitative investors can pump money into—and out of—the markets in a flash. Superfast computers allowed them to revolutionize Wall Street and hasten meltdowns."

***The Rise and Fall of Bear Stearns* by Alan C. Greenberg**
"The former Bear Stearns CEO settles scores with his bridge partner and protégé Jimmy Cayne. The sometimes juicy narrative is colored by years of fights, slights, and betrayals."

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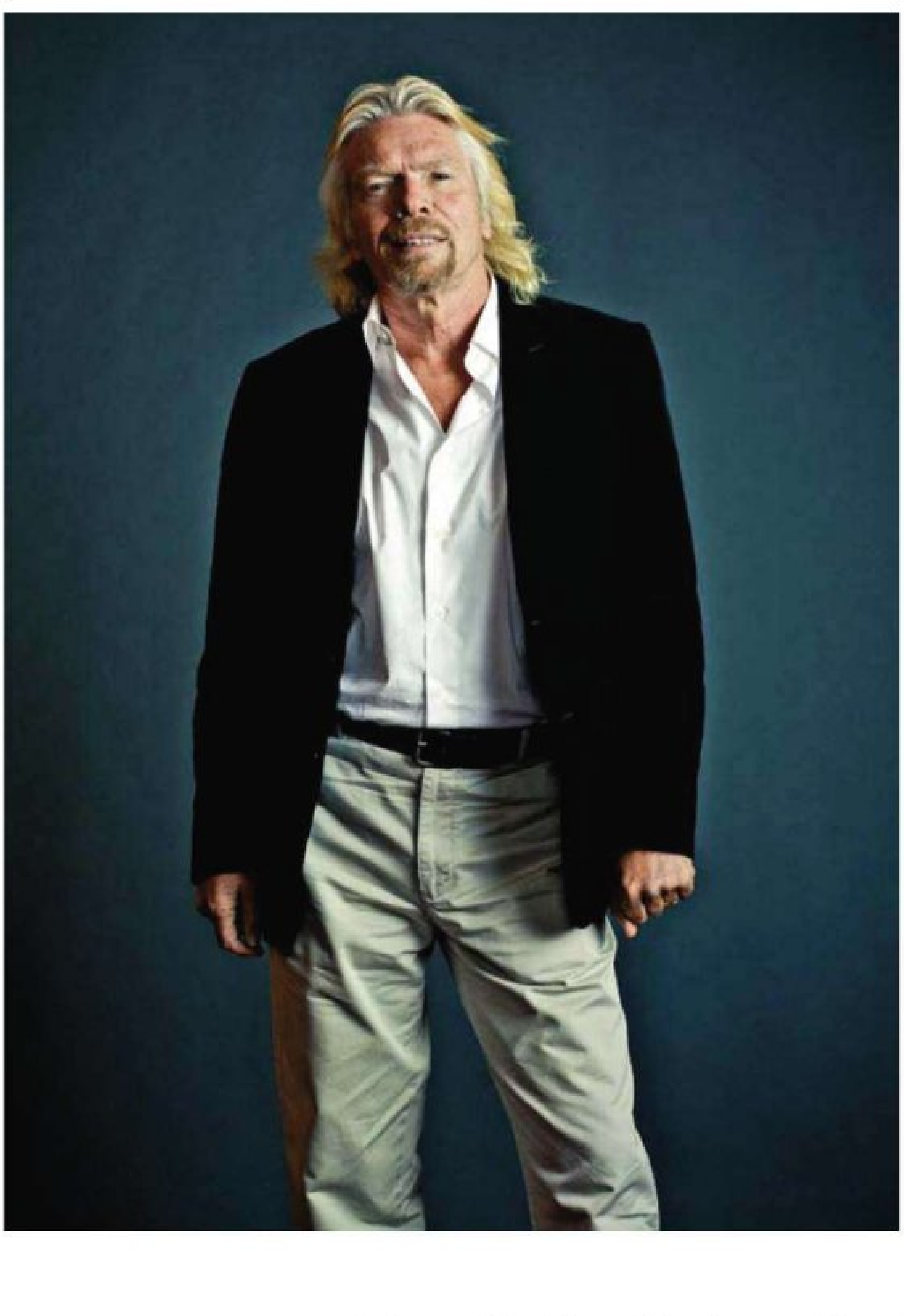
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Etc. Hard Choices

Richard Branson

“The only way to get British Airways to call their tanks off of our front garden was to get a billion-dollar check by selling the record company”

The British mogul on parting with his beloved record label, saving his airline, and contemplating a future merger



I had been running Virgin Records since I was a teenager. By 1992 the record company had just signed Janet Jackson and the Rolling Stones, which felt like an accomplishment. We had tremendous acts: Genesis, Peter Gabriel, the Culture Club, the Spice Girls, the Sex Pistols, and Lenny Kravitz.

At the time, British Airways had launched what became known as the “dirty tricks” campaign to try to drive our airline out of business. We were small and the lengths they went to in trying to get rid of us were considerable. The only way to get British Airways to call their tanks off of our front garden was to get a billion-dollar check by selling the record company. [British Airways apologized and ultimately paid 500,000 pounds in damages to Branson and another 110,000 pounds to Virgin.]

As it turns out, it was likely the best business decision of my life: We sold the company at the peak of the record business. But after telling the staff that we had sold, I set off running with tears streaming down my face. I passed an *Evening Standard* sign that said “Branson sells for 560 million pounds” and realized how bizarre it would look to people if they saw me sobbing my head off.

Before I do anything, I first get tons of feedback. But sometimes I still say “screw it” even if everybody thinks I’m mad. My record company executives said I was crazy to go into the airline business. And I can’t say all of our directors were thrilled with Virgin moving into space travel, but I’m a bit of a maverick. I listen, but I’ve got the final say. Then it’s up to me to make it work so I don’t lose my credibility.

Now the decision is whether the airline can remain independent. We are trying to protect ourselves against the British Airways-American Airlines alliance. It is likely we’ll have to join an alliance, too, even though it’s not something I particularly want to do. I value our independence, and I think the competition authorities have made a mistake in allowing all these airlines to cozy up together. They’ve reset the rules, but we’ve got to play by the new rule book. *—As told to Diane Brady*

PHOTOGRAPH BY BRYCE DUFFY FOR BLOOMBERG BUSINESSWEEK

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